DISCLAIMER

This audit manual is a guideline for assisting and training auditors in the completion of their audits. Every audit is an independent review of a particular taxpayer's books and records. Every audit requires cooperation from taxpayers. If the taxpayer fails to maintain or provide the books and records required by statute or regulation or fails to timely comply with any reasonable request for documents or additional information, the auditor is authorized to use any reasonable procedure or method necessary to obtain the information necessary to determine the correct amount of a tax liability and to apply his or her best judgment in making that determination.

The failure to follow a suggested procedure or method, deviation from a suggested procedure or method, or any additional investigation outside the scope of a suggested procedure or method is at the discretion of the Department and shall not be grounds for invalidating any audit finding. The Department reserves the right to review and revise the work of any auditor and to order or approve procedures or methods that deviate from or are outside the scope of this manual. The Department reserves the right to update, revise, or rescind this manual or portions thereof without notice.

Any references to statutes, regulations, case law, private letter rulings or general information letters are for background purposes for assisting the auditors. Nothing in this manual constitutes an official policy, legal position or interpretation of law sanctioned by the Department's Director, General Counsel or Legal Services Bureau.

This manual is intended for internal use only and if disclosed outside the Department for any reason shall not constitute written legal advice or guidance from the Department for purposes of the Taxpayers' Bill of Rights

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1 CHAPTER 1 – GENERAL AUDIT INFORMATION

1.1 DEPARTMENT OF REVENUE MISSION STATEMENT

It is the mission of the Illinois Department of Revenue to collect state and local taxes as authorized by Illinois laws, to assist as directed with the tax matters of other units of government in this state, and to administer tax related programs as assigned. To achieve this purpose, and to instill public confidence in the integrity and efficiency of the State's tax programs, the Audit Bureau will pursue the following goals:

- Encourage and achieve the highest possible degree of voluntary compliance with Illinois tax laws.
- Work for the adoption of tax laws that are fair, simple to understand, and cost efficient for both the Department and taxpayers.
- Accurately and efficiently collect, deposit, process, and allocate tax revenues.
- Establish clear, concise, accurate and timely communications with the public (taxpayers, legislators, practitioners, employees, etc.).
- Maintain a workforce that demonstrates the highest standards of integrity, efficiency, and performance.

1.2 SAFEGUARDING CONFIDENTIAL AND SENSITIVE TAXPAYER INFORMATION

In the course of fulfilling their official duties, Revenue auditors have access to sensitive taxpayer information which must be kept confidential and safeguarded. The care of official documents is regulated by state law. All records and documents in the custody of Department employees, contractors, or contractor employees are for official use only. The Department has established guidelines which must be adhered to. The Employee Handbook sections on "Care of Official Documents" and "Confidentiality of Information" and PUB-19, Keeping Tax Information Confidential detail these guidelines.

Section 6103 of the Internal Revenue Code (IRC) and the disclosure agreement between the IRS and the Department authorize the IRS to provide federal tax returns and return information to the Department to be used in the administration and enforcement of state tax laws.

IRC Sec. 6103 regarding the confidentiality and disclosure of returns and return information states the following:

(a) General rule.--Returns and return information shall be confidential, and except as authorized by this title--

(1) No officer or employee of the United States,

(2) No officer or employee of any State, any local child support enforcement agency, or any local agency administering a program listed in subsection (l)(7)(D) who has or had access to returns or return information under this section, and

(3) No other person (or officer or employee thereof) who has or had access to returns or return information under subsection (e)(1) (D)(iii), paragraph (6), (12), or (16) of subsection (l), paragraph (2) or (4)(B) of subsection (m), or subsection (n),

shall disclose any return or return information obtained by him in any manner in connection with his service as such an officer or an employee or otherwise or under the provisions of this section. For purposes of this subsection, the term "officer or employee" includes a former officer or employee.

Internal Revenue Publication 1075 - TAX INFORMATION SECURITY GUIDELINES FOR FEDERAL, STATE, AND LOCAL AGENCIES - *Safeguards for Protecting Federal Tax Returns and Return Information*- is intended to provide guidance in ensuring that the policies, practices, controls, and safeguards employed by recipient agencies or agents and contractors adequately protect the confidentiality of the information they receive from the IRS. Publication 1075 can be viewed on the IRS website at www.irs.gov/pub/irs-pdf/p1075.pdf

1.2.1 DEFINITION OF FEDERAL TAX INFORMATION (FTI) – IRS PUBLICATION 1075

Safeguarding FTI is *critically important* to continuously protect taxpayer confidentiality as required by the IRC 6103. FTI may consist of returns or return information and may contain personally identifiable information (PII).

FTI is any return or return information received from the IRS or secondary source, such as SSA, Federal Office of Child Support Enforcement or Bureau of Fiscal Service. Examples include:

- copies of returns,
- Revenue Agents Reports (RAR),
- transcripts, or
- any information received in electronic format such as extract files (IMF, IRMF, IRTF, BMF, LEVY Source, etc.).

FTI also includes any information created by the recipient that is derived from return or return information received from the IRS such as:

- screen prints
- detailed reports with specific taxpayer information, or
- audit workpapers created from FTI.

In addition to the paper and electronic information that we receive or produce directly from the IRS source information, the Department will also use FTI to match, verify and update information within our tax system. When FTI and non-FTI data reside on the same paper, electronic media, or data center, the information is considered to be commingled. If the IRS sourced information replaces some of the taxpayer-provided information in GenTax, then the information becomes commingled FTI. Commingled information must be treated like FTI with the same security provisions in Publication 1075.

FTI does *not* include return information provided by or through the taxpayer or taxpayer's representative. While the information itself may be the same, the key determining factor is the **source**. If the source is the IRS, then it is FTI. If the source is the taxpayer or the taxpayer's representative, then it is NOT FTI. It is considered state tax information (STI), which must still be treated as confidential, but it is not subject to the federal penalties for improper disclosure of FTI.

1.2.2 REQUESTING FEDERAL TAX INFORMATION

When Federal tax return information vital to an audit cannot be secured from the taxpayer, a copy of the information can be requested from the Internal Revenue Service (IRS).

1.2.2.1 EXCHANGE AUTHORIZATION

Internal Revenue Code (IRC) Section 6103(d) outlines the disclosure agreement between the Internal Revenue Service (IRS) and State Audit Agencies and authorizes the IRS to provide federal returns or return information to the Illinois Department of Revenue to be utilized in the administration and enforcement of State tax laws. In order to maintain the privilege of receiving federal returns or return information from the IRS, it is imperative that the following procedures be followed.

IRC Section 6103(b)(1) defines the term "return" as "any tax or information return, declaration of estimated tax, or claim for refund required by, or provided for or permitted under, the provisions of this title which is filed with the Secretary by, on behalf of, or with respect to any person, and any amendment or supplement thereof, including supporting schedules, attachments, or lists which are supplemental to, or part of the return filed."

IRC Section 6103(b)(2) defines the term "return information" as "a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, over assessments, or tax payments, whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing, or any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or

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offense, and any part of any written determination or any background file document relating to such written determination which is not open to the public inspection under IRC 6110."

IRC Section 6103(p)(4) outlines the safeguards to be taken with federal return information. IRC Section 6103(p)(4) provides that,

> "... any agency, body, or commission ... shall, as a condition for receiving returns or return information--
>
> (A) establish and maintain, to the satisfaction of the Secretary, a permanent system of standardized records with respect to any request, the reason for such request, and the date of such request made by or of it and any disclosure of return or return information made by or to it;
>
> (B) establish and maintain, to the satisfaction of the Secretary, a secure area or place in which such returns or return information shall be stored;
>
> (C) restrict, to the satisfaction of the Secretary, access to the returns or return information only to persons whose duties or responsibilities require access and to whom disclosure may be made under the provisions of this title;
>
> (D) provide such other safeguards which the Secretary determines (and which he prescribes in regulation) to be necessary or appropriate to protect the confidentiality of the returns or return information."

Employees should be aware of the penalties imposed for unauthorized disclosure or unauthorized use of "FTI." These civil and criminal penalties apply even though the unauthorized disclosure(s) may have occurred after their employment with the agency was terminated.

1.2.2.2 CRIMINAL PENALTIES FOR UNAUTHORIZED DISCLOSURE

Unauthorized disclosure of federal returns and/or return information, in any matter, that could identify a taxpayer constitutes a felony under IRC Section 7213 and is punishable, upon conviction, by a fine not exceeding $5,000 and/or up to five years imprisonment, plus the costs of prosecution.

1.2.2.3 CRIMINAL PENALTIES FOR UNAUTHORIZED ACCESS OR INSPECTION

On August 5, 1997, the Taxpayer Browsing Protection Act was signed into law. The Act provides a criminal misdemeanor penalty for the willful, unauthorized access or inspection of "FTI". Tax information includes all returns and return information in either paper or electronic format.

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The penalty for unauthorized access or inspection is a fine of up to $1,000 and/or imprisonment up to a year. This applies to all federal employees, state employees and contractors who receive federal tax information under provisions of IRC Section 6103.

1.2.2.4 CIVIL DAMAGES FOR UNAUTHORIZED INSPECTION OR DISCLOSURE

In addition to the criminal penalties, IRC Section 7431 permits a taxpayer to file suit for civil damages for willful or negligent disclosure of federal tax information. The court may award actual damages sustained as a result of such unauthorized disclosure, as well as punitive damages in the case of willful disclosure which is the result of gross negligence, plus the costs of the action. However, in no instance will the award be less than $1,000 for each act of unauthorized disclosure for which the defendant is liable, plus the costs of the action. The taxpayer has up to two years from the time the unauthorized disclosure is discovered to file suit.

The Act also provides a cause of action for civil damages for unauthorized inspection or disclosure. For each act of unauthorized inspection or disclosure, upon a finding of liability, those damages could amount to $1,000 or actual damages, whichever is greater. In the case of gross negligence or a willfully unauthorized inspection or disclosure, punitive damages may also be assessed. When an employee is indicted for unauthorized access, inspection or disclosure of tax information, the IRS is required to notify the affected taxpayer.

Per IRC Section 7432, upon a finding of liability on the part of the defendant, the defendant shall be liable to the plaintiff in an amount equal to the sum of-

(1) the greater of-

(A) $1,000 for each act of unauthorized inspection or disclosure of a return or return information with respect to which such defendant is found liable, or

(B) the sum of-

(i) the actual damages sustained by the plaintiff as a result of such unauthorized inspection or disclosure, plus

ii) in the case of a willful inspection or disclosure or an inspection or disclosure which is the result of gross negligence, punitive damages, plus

2) the cost of the action.

1.2.2.5 REQUESTING FEDERAL TAX INFORMATION

Every attempt should be made to obtain FTI in the following order:

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a. From the taxpayer. Unless the taxpayer is a true non-filer, the taxpayer should be able to provide their federal return information.

b. From the Data Warehouse. The auditor needs to thoroughly research the information available in the warehouse. Field staff who does not have access to the warehouse must contact the Income Tax Audit Planning Technical Support Supervisor (ITAPTS) for warehouse information.

   - When checking records in the warehouse, need to change "Default" view from the "View 1" to see everything available in each file.
   - Most often what is available in the warehouse provides more detail than a transcript will provide.

   Note: Anytime that a number is taken from the Data Warehouse (Federal information) and transferred onto Audit documentation (i.e. EDA-25), it is then considered Federal Tax Information (FTI) and must be protected with a Federal folder and tracking sheet. However, if Line 1 AGI is only being verified through the Data Warehouse (without changing the taxpayer source information or printing it for an audit file), it is NOT considered FTI and does not require the folder/tracking sheet. In such a case, auditors should state that the taxpayer's filings have been verified using "available IDOR resources" not the federal warehouse.

c. From the Disclosure Officer. IRS Form 8796-A should only be completed and submitted to the disclosure officer as a last resort to obtain federal information.

   - Transcripts can only be ordered for the last three years. Information often provided in a transcript does not help in an audit.
   - Copies of returns can be ordered, but can take a considerable amount of time (6 months is not uncommon).
   - The Disclosure area is under new, more stringent IRS security measures which include new requirements in tracking the requests that are handled. On the next IRS review, it is important to show that the Department is not continually ordering transcripts for information that is already available (such as on the warehouse).

REQUESTS GUIDELINES

- Current individual returns (U.S.-1040's) due on April 15th should not be ordered until July 15th or after. Current corporate returns (U.S.-1120's) due on March 15th with an extended due date of September 15th should not be ordered until December 15th or after.
- Actual copies of prior year returns (both U.S.-1040's and U.S.-1120's) which precede the current year by more than six years may not be available.
  - If needed, the auditor should still request returns that precede the current year by more than six years.

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- If the IRS is unable to provide a copy of the original return they may still be able to provide a microfilm printout of the return.

In either case, the IRS will respond with whatever information is available.

1.2.2.6 FORM 8796-A, REQUEST FOR RETURN/INFORMATION

IRS Form 8796-A, Request for Return/Information, should only be used as a last resort by the Audit staff when requesting FTI. This form can be accessed in the Audit Work Area on the sp●IDOR web. Form 8796-A (as shown below) is available in the Work Area as a "fill-in" PDF file, which can be filled in, saved and printed.

Request for Return / Information

(Federal/State Tax Exchange Program - State and Local Government Use Only)

SECTION A

Return to

Internal Revenue Service
Disclosure Scanning Operation
Stop 93A
Post Office Box 621506
Atlanta, GA 30362-3006

I am requesting the following identified return(s) / return information under terms of the Federal / State Tax Coordination Agreement. I understand disclosure or use of the information received for other than authorized tax administrative purposes is subject to criminal and civil liabilities under sections 7213 and 7431 of the Internal Revenue Code.

SECTION B

1. Name of Taxpayer | SSN / EIN

Address

2. Information Requested | Tax periods | Type of return forms

Copy of return(s) ☐ Yes ☐ No

Check the appropriate block
☐ Transcript
☐ Audit Workpapers
☐ Outstanding balance of assessments including penalties and interest computed to _____ *(date)*
☐ Other *(Specify below)*

3. Reason requested (*Check the appropriate block*)
☐ Pending Examination ☐ Criminal Investigation
☐ Pending Collection Activity ☐ Other *(Specify)* _____

SECTION C

1. Name of employee making request | Date request made

2. Group Manager Signature | Group Manager phone number | Division / Branch / Group

3. From *(Signature / Authorized Representative)* | Date signed | Telephone number

4. Requesting Agency

Agency name
Illinois Department of Revenue
Attention
Alison Wrona
Street address
101 West Jefferson Street, MC 1-214
Street address

City, State, ZIP code
Springfield, IL 62702

Instructions for Form 8796-A, Request for Returns/Information under Federal/State Exchange Agreement

The form may be used by state and local tax agency personnel requesting return(s) or return information from IRS.

Complete Sections A, B and C. After signature approval, forward to the pre-printed address in Section A. State the agency's need and use for the requested data as specifically as possible in section B-3. A general statement that it is needed for tax administration is insufficient.

Note: Do not send expedite requests or other requests that require local handling to the address in Section A. Contact your local Disclosure Office. If the office agrees to expedite or otherwise handle your request locally, you will submit it directly to that office.

Form **8796-A** (9-2011) Catalog Number 58558D www.irs.gov Department of the Treasury-Internal Revenue Service

1.2.2.7 COMPLETING FORM 8796-A

The following information should be entered on Form 8796-A:

In order to become compliant with the IRS safeguard review recommendations, it will be necessary for the request for transcripts or other federal information to have the audit tracking #, legal docket #, CID case #, or the most current FSEU letter ID #, placed on the top of the request. The request must also be signed by a supervisor or manager.

Section B

All of Section B should be completed. When entering the taxpayer's address, the zip code MUST BE entered as the IRS uses zip code information for research purposes.

- In Section B – 2.Information Requested, multiple tax periods (years) may be requested on a single Form 8796-A.
  - If you check the box for copy of return, you will receive a complete copy of the ORIGINAL return including all of the schedules and statements attached to the ORIGINAL return by the taxpayer.
  - If you check the box for copy of transcript, you will receive a transcript that shows the original return and all of the adjustments (i.e. math. errors, amended returns, RAR's, etc.) that have been made to the original return.
  - If you check the "other" box, you must give a detailed explanation as to the information required. The "other" box may also be used for ordering a copy of an RAR, but this must be specified.

It is important to realize that multiple boxes may need to be checked in order to receive the appropriate tax information for a given taxpayer.

Example: An auditor needs any and all tax information available pertaining to a taxpayer's U.S.-1120 return. The following boxes may need to be checked:

1) Copy of Return- provides copy of the original return including all schedules and statements that were attached to that original return,
2) Transcript- provides a transcript that shows the original return and all adjustments made to that return, and
3) Other- provides the option to specify ordering a copy of an RAR, or to specify ordering either U.S.-1040 or U.S.-1120 returns as a computerized printout only.

- In Section B - 3.Reason Requested, check the appropriate box, for audit purposes – "pending examination". The "Federal Tax Information" may be used ONLY for the purpose described here.

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- If a court date is involved, requests for certified data should be made six to eight weeks prior to the court date. The actual court date must be indicated on the form 8796-A. Use the “other” box, and specify “court case” with the date.

Section C

In Section C, the name of the employee making the request and the date should be completed. The requester’s supervisor must affix their signature as the “group manager” and include the division, branch, and /or group applicable.

Additional Information Required

The IRS will disclose returns or return information only to the extent that its need and use are satisfactorily justified for an authorized statutory purpose. For this reason, a detailed explanation of the reason for your request should be submitted with Form 8796-A.

A minimum of 150 days should be allowed for processing a request for copies of the original returns. If no response is received within 150 days, another Form 8796-A should be submitted with "Second Request" and the date of the original request written at the top of the form.

1.2.2.8 ROUTING THE COMPLETED 8796-A

Once Form 8796-A has been filled in, the form should be directed to the requester’s supervisor for signature. After completion by the supervisor, three copies should be printed; one copy should be retained for the requester’s records, while the other two should be forwarded to the Revenue Disclosure Officer (see address in the next section).

1.2.2.9 SAFEGUARD PROCEDURES – HANDLING FEDERAL TAX INFORMATION

Upon receipt of the information from the IRS, the Authorized Exchange Representative will perform the necessary recordkeeping and prepare the “FTI” for transmittal to the requester. The information is placed in a file folder that is clearly identified (i.e., stamped in red) as containing “FEDERAL TAX INFORMATION”. The Authorized Exchange Representative will transmit the FTI folder attached on Form EDA-79 (FTI Transmittal Form), along with Forms IDR-487, Federal Form 8796-A and EDA-80. The Department of Revenue forms are as follows:

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EDA-79 (revision date 07/2015) is a "triplicate" form.

Illinois Department of Revenue

COPY DISTRIBUTION	
White	- Acknowledged copy to send back to originator
Canary	- File copy
Pink	- Originator

Federal Tax Information Transmittal Form

Persons having access to Federal tax information are reminded that civil and criminal penalties for unauthorized disclosure are imposed by Sections 7213 and 7431 or the Internal Revenue Code.

Please acknowledge receipt of the enclosed information by signing below and returning a copy to:
DISCLOSURE OFFICE 1-214
ILLINOIS DEPARTMENT OF REVENUE
101 WEST JEFFERSON STREET
SPRINGFIELD IL 62702

Date:_____ Signed:_____ Title:_____

Requestor:_____

Illinois Account ID:_____

Date transmitted:_____

EDA-79 (R-07/15)

The requester of the FTI is *required* to:

1. *Immediately* acknowledge the receipt of the FTI folder by signing form EDA-79 and return the white copy to the Disclosure Officer at the following address:

   Disclosure Officer
   Illinois Department of Revenue
   101 West Jefferson Street, 1-214
   Springfield, IL 62702

2. The requester and **all** other employees with access to the file *must* initial and date Form-487 advising of disclosure limitations. This form will be attached to the IRS data in the FTI folder. This would include the auditor, supervisor, clerical staff, reviewer, etc.

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IDR-487 (shown below) should be utilized whenever an employee reviews the FTI contained in the folder.

THIS FILE CONTAINS

FEDERAL TAX INFORMATION

DISCLOSURE LIMITATIONS

Unauthorized disclosure, printing, or publishing of federal tax information is punishable by fine or imprisonment. Persons with access to this file must enter information below.

Reviewed by		Forwarded to	
Employee	Date	Location	Date

IDR-487 (R-7/91)
IL-492-0804

Precautions must be taken to safeguard "FTI" obtained from the IRS pursuant to the Federal/State Exchange Agreement. As a reminder, a checklist (Form EDA-80) of the requirements for safeguarding "FTI" will be included in the FTI folder.

EDA-80 (revision date 07/2015) provides this checklist.

Illinois Department of Revenue

Federal Tax Information

Because of the confidentiality laws of the Internal Revenue Service, it is necessary that the Department of Revenue take some extra precautions to insure that federal tax information is secured properly. The following checklist has been developed and should be utilized whenever federal tax information is a part of the Department's workpapers. If additional information concerning the handling of federal tax documents is desired, please contact the Disclosure Office (217 524-7738).

Check-Off List

- ☐ Federal tax information is being stored in a secured manner at all times.
- ☐ Federal tax information is being kept in a stamped federal tax data folder.
- ☐ Federal tax information contained herein has not and will not be photocopied.
- ☐ Federal tax data folder has been placed on the top of the audit file.

EDA-80 (R-07/15)

1.2.2.10 CONFIDENTIALITY

"Federal Tax Information (FTI)" obtained under this agreement is subject to specific rules and guidelines to protect and ensure its confidentiality. Those employees having access to the information are responsible for assuring that it is not misplaced, disclosed to unauthorized persons or used in any manner, or for any purpose, not consistent with the authorized use. "FTI" cannot be given to other states or state agencies.

The potential for improper disclosure will be minimized by restricting access to designated personnel. Accordingly, files containing "FTI" **must be** stored in a locked area, desk or cabinet overnight (with keys properly secured). The same security standards apply to all "FTI" regardless of the media on which it is recorded.

To ascertain that adequate controls are being exercised, the IRS conducts on-site reviews of agency safeguards at least once every three years. Any employee with knowledge of a possible violation of confidentiality standards should report it immediately to his/her supervisor.

NOTE: IITA Section 917 contains the confidentially provisions for all information received by the Department from returns filed under the IITA, or from any investigation conducted under the provisions of the IITA. In addition, the confidentiality guidelines for Federal and State tax information, official documents and manuals are specifically outlined in the Department of Revenue Employee's Handbook.

1.2.2.11 CARE OF FTI

FTI in the Audit Work Environment -
When “FTI” is being used, care should be exercised to ensure that it is not left open on desks and unattended during break or lunch periods. When leaving the office, personnel are to make sure all desks and filing cabinets which contain “FTI” are securely locked.

“FTI” furnished to the Department by the IRS continues to be “FTI” subject to safeguarding **even though it is transcribed onto another document**, such as a workpaper or report. Consequently, workpapers meeting this criteria *must* be labeled as “Federal Tax Information” and *must* be retained in the stamped FTI folder with the original information obtained from the IRS.

All users of the “FTI” are responsible for keeping it in the FTI folder. “FTI” may **not** be photocopied. The FTI folder *must* be placed at the top of the audit file. It must be stored in a secured manner at all times to protect its confidentiality. Any audit file containing a FTI folder must be clearly marked to show that the file contains “Federal Tax Information.” The audit file *must* have an 8 ½ by 11 sheet of paper with the statement **“This file contains Federal Tax Information”** placed on top of the audit file.

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FTI Taken Outside of the Work Environment -
Employees who take "FTI" out of the office are individually responsible for maintaining its confidentiality. Whenever "FTI" is transported, it should be in a **locked** briefcase and stored in a **locked** trunk and if the vehicle does not have a trunk, the briefcase should be placed out of view and the vehicle locked. Employees who do not return to their office at the end of the day should store **locked** briefcases containing "FTI" in their personal residences.

Employees on overnight travel status should use their discretion in determining the best method of storage for "FTI." Good judgment is imperative, as the employee will be held accountable for any loss, disappearance or theft of "FTI" which is attributable to negligence or carelessness. In the absence of a more secure alternative, employees should store **locked** briefcases containing "FTI" in a **locked** hotel/motel room.

Any time FTI is transported from one location to another, care must be taken to provide safeguards. In the event the material is hand carried by an individual in connection with a trip or in the course of daily activities, it must be kept with that individual and protected from unauthorized disclosures. For example, when not in use, and definitely when the individual is out of the room, the material is to be out of view, preferably in a locked briefcase or suitcase.

FTI Being Shipped or Mailed -
All shipments of FTI (including electronic media and microfilm) must be documented on a transmittal form and monitored to ensure that each shipment is properly and timely received and acknowledged. All FTI transported through UPS must be double sealed; that is one envelope within another envelope. The **inner envelope** should be **marked "CONFIDENTIAL"** with some indication that only the designated official or delegate is authorized to open it. Using sealed boxes serves the same purpose as double sealing envelopes, and prevents anyone from viewing the contents thereof. Please refer to the Income Tax Audit Manual, Chapter 20 for information on Audit File Tracking.

These safeguard requirements cease to apply to any return or return information ONLY to the extent they are disclosed in the course of any judicial or administrative proceeding and to the extent they are made a part of public record thereof.

1.2.2.12 DISPOSAL OF FEDERAL TAX INFORMATION UPON COMPLETION OF USE

If an audit is completed, all the "FTI" should be kept inside the FTI folder and placed at the top of the audit file. When the audit is concluded, the FTI folder is maintained with the audit file indefinitely in the Department's records section. An 8 ½ by 11 sheet of paper with the statement **"This audit file contains Federal Tax Information"** should be placed on top of the audit file. The "Original Federal Income Tax Information" box on the R.O.T. Audit Index (Form SC-135) or the "Fed Tax Info" box on the Income Tax Audit Index (EDA-51) should be checked if the enclosed Federal information was obtained pursuant to a request to the IRS. If the information was obtained from other sources (e.g., copies provided by the taxpayer or the taxpayer's accountant) the box should not be checked.

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If no audit is ultimately performed using the "FTI," the FTI folder *must* be returned to the Disclosure Officer for shredding at the following address:

Disclosure Officer
Illinois Department of Revenue
101 West Jefferson Street, 1-214
Springfield, IL 62702

The office or unit returning the FTI folder will **not** have the option of shredding the FTI folder. The office or unit returning the FTI folder is *required* to maintain records showing that the FTI folder was returned to the Disclosure Officer. These records *must* be retained for a minimum five years.

1.2.3 GENTAX FEDERAL TAX INFORMATION (FTI) BANNER

As of Monday, February 29, 2016, a new message (below) will be displayed in Gentax when data is presented that contains Federal Tax Information (FTI).

The message will include a link (i.e. click here) to the IRS required procedure (see steps below) that must be followed if the screen is printed. Therefore, it is highly recommended that screens only be printed when absolutely necessary.

If you print a screen from GenTax that has FTI on it, you must take the following steps:

1) Print the IDR-487-G and staple it to the front of the page containing FTI.
2) Complete the Tracking Log and email it to the Disclosure Officer at REV.DisclosureOfficer@illinois.gov immediately.
3) Security measures must be taken for this screen-print by storing it in a secure area such as a locked desk or filing cabinet, vault, locked room, etc. when not being worked. Any document, report, form, or correspondence that is FTI or contains Social Security numbers, banking information, or entity-specific tax return data should be treated as a confidential document and should be secured at all times.
4) Add an entry on the IDR-487-G any time an individual views the FTI information. Each time an individual looks at the information must be documented.
5) When you are finished with the screen-print, it must be destroyed immediately (placed in a blue locked shred bin for destruction). You must email the Disclosure

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Officer the log again indicating the date the document was placed in the locked shred bin.

1.2.3 GENERAL INFORMATION

Information received by the Illinois Department of Revenue (IDOR) from taxpayer returns is confidential. As Department employees, auditors are entrusted with the responsibility of maintaining taxpayer confidentiality. Failure to do so may result in discipline up to and including discharge. Additionally, unlawful disclosure of confidential taxpayer information is a criminal offense punishable by a fine or imprisonment or both. Virtually all information concerning a taxpayer is confidential and should not be disclosed except when provided for by specific authorization.

Generally, information from returns may be disclosed only within the Department for official purposes as provided for by official procedures for the collection of any state tax or for an official investigation, including internal investigations of employee misconduct.

The Department's policy and procedure manuals **(including audit manuals)** are strictly confidential, and their contents may not be disclosed.

Illinois statutes authorize disclosure of Illinois taxpayer returns and return information to the IRS and the tax-collecting arms of other states, provided reciprocal privileges are granted to the Department. Illinois statutes also allow disclosure of certain tax data to qualifying units of local government. A taxpayer or his or her duly authorized representative may review and copy his or her own returns. The Director of Revenue may authorize the release of taxpayer information to various Illinois state agencies. Certain other tax records may also be disclosed at the discretion of the Director.

Public access to many public records is guaranteed by the Freedom of Information Act; however, tax returns and return information are exempt from Freedom of Information Act disclosure, as are the department's policy and procedure manuals (including audit manuals).

1.2.4 BUSINESS USE OF GENTAX

Auditors must be aware that when signing into the Department's tax system (GENTAX) a warning message appears which details that the user must have a legitimate business use to observe or obtain taxpayer information. The message is as follows:

"Information contained within or generated from the Individual Income Tax and Business Income Tax areas of this system and from the data warehouses contain Federal Tax Information (FTI) that is protected under federal law and may subject you to federal penalties for its misuse. Further, any information contained in GENTAX or received by the department is protected under state law and may subject you to state penalties for its misuse. Unauthorized use of this data is prohibited.

Looking at information that would be considered FTI that you do not have a business purpose for accessing can subject you to fines and possible jail time under federal law. If you disclose taxpayer information to any employee that does not have a business purpose for the information or to someone outside of the department, you can be subject to fines and possible jail time at both the federal and state level. In any situation described above, you may be subject to disciplinary action up to and including discharge. See the details of the potential legal penalties below.

Inspection of taxpayer information received from the federal government except as expressly authorized by federal law may subject you to a fine of up to $1,000 and imprisonment of up to one year. Unauthorized disclosure of taxpayer information received from the federal government may subject you to a fine of up to $5,000 and imprisonment of up to 5 years under federal law. Unauthorized disclosure of any taxpayer information may subject you to a fine of up to $2,000 and imprisonment of up to one year under Illinois law.

Your use of this system will be monitored to assure compliance with the laws. By clicking "Logon" on the Login page you are consenting to the monitoring of your activity on the system.

Unauthorized access or disclosure should be reported immediately to your supervisor and the Disclosure Office at 217-524-7738. Your supervisor must report the incident to Internal Affairs at 217-782-3151 once notified."

1.2.5 USE OF CELL PHONES, CAMERAS, PDAS AND VIDEO EQUIPMENT

The Audit Bureau recognizes that cell phones and personal communications devices have become valuable tools in managing our professional and personal lives. However, use of these devices in the workplace can raise a number of issues involving safety, security, and privacy. To safeguard its confidential information and to reduce the opportunities for illegal harassment, the Audit Bureau and other sections are regulating the use of electronic equipment used to capture images such as camera phones, camera PDAs, video equipment, cameras, handheld scanners, flash drives, and any other device capable of capturing or storing an image or data in its facilities. This policy does not apply to equipment without imaging capabilities. Therefore, Account Processing, Information Technology, Collections, Audit and Taxpayer Services have adopted the following rules regarding the use of such personal devices in the workplace during working hours.

1. Except in cases of emergency, reasonable time for union stewards to engage in union business, and matters which cannot reasonably be attended to during your break time or lunch, employees should conduct non-departmental business during lunch and breaks. Use of personal cell phones, texting devices or personal communication devices even under these exceptions should occur away from the work area so the devices are not out around confidential information or so as not to disturb co-workers.

This includes the use of personal devices (including cell phones) for personal business (including but not limited to personal phone conversations and text messages, personal e-mails, and use of the Internet for personal reasons). Employees should be considerate of their co-workers and keep ring tones and alerts on vibrate or silent while at work. Personal phone calls made during an employee's lunch or break period should be made away from any work area so as not to be out around confidential information or so as not to disturb co-workers.

2. When attending a meeting with customers, clients, or co-workers, employees should turn off or silence their personal cell phones and personal communications devices. Except in extraordinary circumstances (e.g., family emergency), employees may not respond to personal calls during a meeting.

3. Employees are prohibited from using any electronic device's camera to take photographs in the workplace without permission from Internal Affairs. Phones and other devices with cameras or recording capabilities are strictly prohibited from being out in all Account Processing, Information Technology, Collections, Audit and Taxpayer Services work areas in order to protect confidential documents. Camera phones and other devices with photographic or recording capabilities may not be used in restrooms, locker rooms, nursing mother's room, or other private areas in the workplace.

4. Personal cell phones with cameras and other devices with cameras or recording capabilities shall not be left out on a desk in Account Processing, Information Technology, Collections, Audit or Taxpayer Services, and shall be holstered with the camera covered or put away while in Information Technology, Account Processing, Collections, Audit or Taxpayer Services, such as in a desk drawer, brief case, purse or pocket.

5. Unauthorized use of the camera function on any electronic device on Illinois Department of Revenue property is strictly prohibited, and any violation will be grounds for discipline up to and including discharge.

6. Any person using a personal cell phone with a camera or other personal devices with cameras or recording capabilities within the jurisdictions of the Illinois Department of Revenue for photographing, copying, recording or by any means accessing taxpayer, Department, co-worker or any other information without a specific work related purpose or authorization, are subject to discipline up to and including discharge.

Employees are to report any violations of this policy immediately to their supervisor. Supervisors are to report immediately any violations of this policy to the Program Administrator, or their designee, who in turn may notify Internal Affairs.

Employee's electronic devices that are brought into Account Processing, Information Technology, Collections, Audit or Taxpayer Services work area are subject to inspection by

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Internal Affairs if the Department has reasonable cause to believe a picture or other recording may have been made with the device, to ensure compliance with this policy. Any unauthorized recording taken or present relating to the Department is considered Department Property. Any recordings found in violation of this policy are subject to confiscation.

The handbook sets forth the policies for the entire Department. Program Area Directives provide the policies applicable to a program area, division, bureau or unit as designated in that directive. Program Area Directives and Handbook Policies should be read and construed together to give full force and effect to all directives and policies. However, Program Area Directives approved by the Director take precedence over the Handbook to the extent there is any conflict.

Violation of this policy may result in discipline, up to and including discharge.

1.3 GENERAL AUDIT POLICIES

Audit contact is of great importance to efficient administration of Illinois tax laws. Audit activity helps to insure that taxpayers pay their correct tax liability, detects and aids in the timely correction of reporting errors and promotes the timely filing of returns. In addition, audit contacts are responsible for a large portion of self-assessed tax that would not otherwise have been paid without this improved reporting. Department management has the responsibility to carry out the policies set forth in this manual. They will issue necessary instructions to implement policies.

1.3.1 PURPOSE OF AUDIT ACTIVITY

The taxes administered by the Department require self-assessment by the taxpayer. An audit program is essential to provide for the following objectives:

1. Promote voluntary compliance and deter tax evasion at minimum cost through systematic selection of accounts and efficient compliance techniques.
2. Educate taxpayers to insure proper completion and filing of various tax returns.
3. Administer fair and equitable treatment of overpayments and refunds, as well as deficiencies and delinquencies.

1.3.2 TAXPAYER RELATIONS

All taxpayers are entitled to equitable treatment under the law. Many legal issues are involved in the administration and enforcement of the Revenue Acts which govern the activity of the Department of Revenue.

It is in the best interest of the Department that the auditor always remember to be of service to the taxpayer. In many cases, the auditor will be the only representative of the Department with whom the taxpayer will have personal contact. Most taxpayers are fully cooperative even

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though tax matters are seldom regarded as welcome aspects of business activities. The auditor's objective with the few taxpayers who do not, or will not, recognize their responsibilities, is to make a courteous but persistent effort to bring them into compliance.

During all work activities the Department expects the auditor's conduct to be beyond reproach. It is important that careful attention be given to presenting a neat and professional appearance when calling on taxpayers, or at any time when in the public view, performing official state business. The impression that an auditor makes on taxpayers will be determined not only by personal conduct and appearance, but also by a thorough knowledge of all Revenue Rules and Regulations and the manner in which they are applied.

There is never an occasion for audit personnel to harass taxpayers or to impress them with the thought that the objective is to find something wrong. The taxpayer should be assured that an auditor's function is to determine whether the correct amount of tax has been reported. The auditor is expected to aid the taxpayer in gaining a correct understanding of the law and should demonstrate that the Department is willing to acknowledge overpayments or errors which benefit the taxpayer. Care should be taken to inform taxpayers of their rights and privileges. Keep in mind it is the Department's policy to administer the law fairly and uniformly, with minimum inconvenience to taxpayers' business affairs.

1.3.3 CREDENTIALS

All auditors have been provided with official Department credentials. **Present them to every taxpayer for positive identification before asking to see any books and records**. Credentials are for official use only. Any unauthorized use may result in disciplinary action.

If an auditor's credentials are lost or stolen, the auditor must immediately notify his or her supervisor. The supervisor will contact and notify the Personnel Office and the Internal Affairs Office. The auditor will be required to complete form **RPS-53, Badge Replacement Application.**

1.3.4 PROFESSIONALISM

Auditors are engaged in professional assignments and are asked to exercise the highest skills and impartial judgments while performing their official duties. The assignments should be worked in accordance with approved procedures and techniques. Under all circumstances, auditors are expected to observe the rules of conduct of profession and to perform the duties with dignity and courtesy.

1.3.5 COOPERATION WITHIN AGENCY

Revenue Collection Officers, Revenue Auditors and Criminal Investigators are encouraged to exchange information. When auditors anticipate an unagreed or an agreed audit without payment, the financial data secured during the audit must be documented on form EDA-8-A.

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Similarly, the Collection Officer may be able to provide information about previous dealings with a taxpayer. Likewise, auditors should always be cognizant of potential violations involving fraud or potential criminal activities. The auditor's observations and findings should be discussed with Investigations personnel. Communication and coordination between Collections, Audits, and Investigations can save time and improve overall compliance.

1.3.6 DEPARTMENT PROPERTY

In order to perform the duties of an auditor, Department property such as ~~manuals,~~ credentials and equipment will be assigned to the auditor. Auditors are responsible for maintaining all Department property assigned to them and will be required to return it when leaving the Audit Bureau.

Promptly report the loss or theft of any State property (e.g. laptop computer) to the Revenue Audit Supervisor. Auditors must also report the loss or mutilation of any official record or document such as tax returns, informal letters, or audit reports and must report damage or loss of state equipment such as state vehicles or office machines. The Revenue Audit Supervisor will contact and notify the Internal Affairs Office.

1.3.7 PUBLIC SPEAKING POLICY

Department personnel are not allowed to make public appearances on behalf of the Department until they are cleared for such assignments by the Director or his/her designee. All requests for audit personnel to speak should be routed through the Program Administrator

1.3.8 WRITTEN OPINIONS

Verbal opinions from Department employees are not binding on the Department. 86 Ill. Adm. Code 130.1001(a), When Opinions from the Department are Binding, states the following:

"Taxpayers may not rely on verbal opinions from Department employees. For Department rules concerning the binding effect of Private Letter Rulings and General Information Letters, see 2 Ill. Adm. Code 1200."

The Department issues two types of letter rulings; Private Letter Rulings and General Information Letters.

Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. For that reason, it is the policy of the Department that written opinions regarding laws administered by the Department are to be rendered only by the Legal Services Bureau.

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Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110.

Beginning July 1, 2002, every private letter ruling is revoked on the date that is 10 years after the date of issuance of the ruling or July 1, 2002, whichever is later. No ruling may be cited or relied upon for any purpose after the date of its revocation, and the ruling will cease to bind the Department after the date of revocation. Taxpayers, entitled to rely on the opinion contained in a particular letter ruling, must apply for a new letter ruling prior to the aforementioned revocation date. For more information see 2 Ill. Adm. Code 1200.110. Each PLR contains a paragraph explaining that the Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of that letter.

The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. (2 Ill. Adm. Code 1200.120.)

These letter rulings are published and are available on the Department's website. Taxpayer and business names are removed from the letters before they are published and are only available for the 10 year period. Auditors are not to give taxpayers letter rulings which have other taxpayer names in them or are older than 10 years.

1.3.9 CARE OF TAXPAYER RECORDS

Extreme care should be taken with respect to the books and records and other material presented by taxpayers for examination. Auditors should not write or mark on original documents and records presented to them by the taxpayer. Auditors should always return all records to the taxpayer when they have finished reviewing them. The examination of the records should not prevent the taxpayer from conducting normal business operations. If a taxpayer allows an auditor to remove records from the normal place of business, then the auditor must give the taxpayer a receipt at the time they are removed. The auditor must also ask for a receipt when returning the records.

1.3.10 AUDIT FILE TRACKING PROCEDURES

A. Mailing of Audits to Revenue Offices:

It is the Department's policy that the mailing of audit files be processed through UPS. When an audit file is sent through UPS, a tracking number with expected date of delivery should be obtained. This information (any tracking number and expected delivery date) should be included in the email required when mailing an audit file.

Note: This shipping/mailing policy provides for the use of the UPS on-line account established for the Audit Bureau at the Department of Revenue. When this shipping account is used, the sender needs to put their name on the shipment as "sender". This provides quick

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verification for the Department when reviewing the UPS bills that have been charged to the Audit Bureau/Department.

Auditors should **not** ship items via overnight or next day air. The only exception to this is if a file has to be sent due to statute issues, or a computer needs to be exchanged. With these two exceptions, all other shipping should be done by ground transportation.

In order to use the UPS on-line account, the auditor must do the following:

1) Go to www.ups.com to begin the process.
2) By registering a user ID and password on this site, the auditor can ship on account numbers already established for the Audit Bureau. These account numbers are [redacted]

   When either shipping account is used, the sender (auditor) needs to put their name on the shipment as "sender".

   When registering, the auditor will be able to save to an address book, making future shipments to the same recipients quicker and easier.
3) When setting up the account to access these Shipper Numbers, there will be some information required that the auditor will not know. The auditor will be asked for information linked to the specific account that is being accessed. The auditor must call [redacted] at [redacted] so that [redacted] can provide the proper information required.

   Beth receives a weekly billing for each of the accounts that are used by the staff in the Audit Bureau. She monitors and reviews all activity on these bills to make sure all charges are legitimate and then denies or approves for processing. Thus, in using these accounts the auditor should not see an actual bill or have to pay for it out of pocket. And, no one should be using the accounts for anything other than Department of Revenue business.
4) Once the online form is completed, the auditor should print out a label and affix it to the package. A pickup can be requested or the package can be taken to a UPS location.

Proper shipping procedures **must** be followed. Any taxpayer information being mailed / shipped should be double sealed. Documents must be placed in an envelope (or box, if needed) and then sealed prior to being placed in the mailing box for shipment. This inner packaging needs to be labeled "Confidential". The shipping address information must be included on the inner packaging. If the mailed box is damaged during shipment, the 2nd seal and inner address information provides additional security.

Note: When packaging audits for shipment, it is essential that each audit be **individually** sealed and properly labeled before being placed in the shipping box. This allows for easier identification, by both the sender and the receiver, as to the audits in that shipment. All audit

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files must be marked as CONFIDENTIAL and double sealed per IRS Publication 1075, Section 4.5.

B. Audit Movement between Revenue Offices:

Whenever an audit file is sent or transported between two Revenue offices, an email is required stating the date that said audit is being sent. This email should have the scanned transmittal attached.

The receiving office should then email a response back to the sender when the audit is in their possession. This email trail is required to ensure that audits can be properly tracked between these offices.

All audit files must be marked as CONFIDENTIAL and double sealed per IRS Publication 1075, Section 4.5. The package should be taken to the mail room with instructions that the package is to be mailed via **UPS**. Audits containing Federal Tax Information or State Tax Information (FTI/STI) are no longer allowed to be sent via the CMS truck.

Delivery may take up to ten (10) business days depending on the mailing location.

C. Determination that an Audit File is Missing:

If the audit file fails to reach the intended recipient within the expected delivery date(s) as stated in the email, the intended recipient should first verify with the sender that the audit file in question was actually sent on the date originally intended. After such confirmation, the intended recipient should email the appropriate Supervisor, Assistant Division Manager (ADM) and Division Manager (DM) that the audit file was not received and is missing.

Once it is determined that the file is missing, the Program Administrator, the Director (of Revenue) and Internal Affairs will need to be contacted about this matter. The Division Manager, who is over the staff that sent the audit file, will be responsible for informing the Program Administrator, and then the Director and Internal Affairs that an audit file is missing. The Division Manager will then need to contact the Department's Disclosure Officer for proper notification of the IRS and the Treasury Inspector General for Tax Administration based on the following:

Any file that has been determined to be missing that may contain confidential Federal Taxable Information (FTI) will require **immediate** notification to:

(1) The IRS, through the Disclosure Officer, under the provisions of IRC Code (26 U.S. Code Section 6103(a)) as documented in IRS Publication 1075, Section 4.5. The Director and Internal Affairs will also need to be informed that this missing file may contain FTI.

(2) The office of the appropriate Special Agent-in-Charge, Treasury Inspector General for Tax Administration (TIGTA), also through the Disclosure Officer.

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- The TIGTA Field Division serving Illinois is located in Chicago with the contact phone # (312) 886-0620 X 104.
- Mailing address: Treasury Inspector General for Tax Administration, Ben Franklin Station, and P.O. Box 589, Washington, DC 20044-0589.
- Complete procedural details for TIGTA and IRS notification should be followed at http://www.irs.gov/uac/Reporting-Improper-Inspections-or-Disclosures

    - Per these notification details, the IRS and TIGTA need to be contacted immediately, but no later than 24 hours after identification of a possible issue involving FTI. The affected agency should not wait to conduct an internal investigation to determine if FTI was involved. If FTI may have been involved, the agency must contact the IRS and TIGTA immediately.

    - The Division Manager should be the party responsible for writing the Data Incident Report required by the IRS (see link above). However, the Disclosure Officer should be the contact person for the IRS and TIGTA.

If it is later determined that no FTI was in the file, the Disclosure Officer would need to be informed so that proper notification is made to the IRS and TIGTA.

Note: Although this section addresses when an audit file is missing, it is important to realize that FTI may be contained in other Department documentation beyond just an audit file. The above procedure should be utilized with any lost (or missing) FTI.

D. Audit Transmittal Form in GenTax:

It is important to realize that not all audit staff may have rights in GenTax for changing the audit stage or generating an Audit Bureau transmittal form. Auditors conducting the audits cannot generate the "Bureau Transmittal Form". This report can **only** be generated by those staff members whose responsibilities include changing the Audit Stage on the Audit Springboard.

1. CHANGING THE AUDIT STAGE IN GENTAX

Before an Audit Bureau Transmittal form can be generated in GenTax, the audit stage **must** be changed first. The stage would be changed to reflect where or to whom the documents are being moved / mailed to.

2. GENERATING THE AUDIT BUREAU TRANSMITTAL FORM

The Audit Bureau Transmittal Form is a descriptive listing of the audit files that are being moved (or mailed). This form can be generated (and saved) within GenTax in

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the Report Manager and should be used when sending audit files. Click on the Report Manager icon in the New Manager to open.

Click on the “Report List” Tab. By entering “bureau transmittal” in the green search line (then hit enter), the Bureau Transmittal Form will show under *Title*. Click on that form title.

The Bureau Transmittal Form Details box will open allowing for information to be entered for generating the transmittal form.

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- The “From” box allows free form typing to enter either the person or area sending the audit files.

- The “To” box has a drop down listing of different areas. The most appropriate area should be chosen. Examples would be - to “Audit Review MC 3-355” when sending audits in from the field, or to “Field Office” when returning audits for field correction.

- In the “Stage” box drop down, the appropriate stage should be selected. The audit stage appearing in GenTax must match the stage being selected in the transmittal “Stage” box, in order for that particular audit information to appear on the transmittal. Example: the stage “Passed to Clerical” (a new drop down choice) may be used when sending audits to the individuals (Chicago/East Coast staff) who enter the PROD-1s, then the stage would be changed to “Transmitted to Technical Review” when shipped on to Springfield.

- The “Date change From” and “Date change To” boxes should be the date the transmittal is being completed (or if started one day (from) and completed the next (to)). It is **important** that the day that the transmittal is being generated, is the same day that the audits will be mailed (or moved). The required email must also be sent that same day.

- In the “Tax Groups” box, either Income Taxes, or Sales and Misc Taxes should be selected dependent on the tax type.

- The “Account Type” box provides a listing of tax forms and adjustments, but will not be accessed if either Income Taxes, or Sales and Miscellaneous Taxes have been selected in the “Tax Groups” box.

- The “Poster” box has an entire listing of audit staff. The person who changed the stage in GenTax (and who is also generating the transmittal) will be the “poster”.

Once the boxes have been filled, click on the “Generate” tab to generate the transmittal.

The completed transmittal form should appear on the screen. Select the appropriate printer and print two copies. One copy goes in the shipping box with the audit files, and the other is retained for a record of shipping.

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If multiple audits are being mailed in more than one box, cases listed on each transmittal should correspond only with the contents of each respective box.

The transmittal can also be "exported" as a pdf and attached to an email. Since an email is required per this procedure, attaching the transmittal (as a pdf) informs the receiver as to what audit files should appear in the shipment. The transmittal can also be saved to an electronic file, if desired.

Note: It cannot be stressed enough that to ensure accurate tracking of audit files, the stage in GenTax must be changed before the transmittal is generated.

1.3.11 ACH CREDIT PAYMENTS

ACH Credit is an electronic payment method in which the taxpayer instructs their financial institution to transfer funds from their account to the Department's account. The tax payment received by the Department is then applied to the taxpayer's tax liability. For taxpayers who are paying audit liabilities electronically, this is the preferred method for electronic payments.

In order for the taxpayer to pay audit liabilities using ACH Credit, the following information should be provided: (**Note: The Treasurer's Office has asked that the bank account information not be placed in unencrypted e-mails going outside the IDOR firewall. Therefore, the ACH Transaction Detail listed below is not to be e-mailed to taxpayers.**)

ACH Transaction Detail Instructions:

Format: [redacted]
Bank Name: [redacted]
Routing Number: [redacted]
Account Name: [redacted]
Account Number: [redacted]

Addenda Info:

In the addenda record there is room for 40 characters of identifying information. The first four spaces should be used for the last four digits of the Treasurer's Clearing account number. **The last four digits of this account number are [redacted]. Enter these four digits in the first four spaces.** The next space should be left blank. The remaining 35 spaces can be used to identify the taxpayer originating the ACH. See the example below for a properly formatted addenda.

Example

[redacted]ABC Services Company International

In this example, the "[redacted]" represents the receiving agency's clearing account number and "ABC Services Company International" represents the name of the vendor (taxpayer) originating the ACH.

Once the taxpayer is given the ACH Credit information, the auditor will need to know the exact amount of the payment that will be submitted and the date the payment will be submitted (the settlement date) for the payment.

The auditor must send an e-mail addressed to the following people immediately after being notified from the taxpayer of the payment amount and the date the payment will be submitted. This needs to be done to guarantee that the payment will post correctly on GenTax. This also needs to be done for investment purposes.

Address the e-mail to:

- [redacted] (IDOR Financial Control)
  [redacted] (IDOR Financial Control)
- The Audit Perfection Supervisor for Income Tax or the Audit Review and Perfection Supervisor for Sales Tax. (This supervisor will check Gentax to ensure that the payment was posted and applied appropriately).
- The auditor's own supervisor

The e-mail must contain the following information:

- E-mail subject line: Audit payment submitted by ACH Credit

- The text of the e-mail:

  Identify the taxpayer: give the taxpayer's name exactly as shown on GenTax, the taxpayer's address, the tax type for which the payment is being made (income tax, withholding tax or sales tax), provide the account ID and provide the Audit ID number.

  State the exact amount of the audit payment that was made.
  Provide the date the payment will be submitted (the settlement date) as provided by the taxpayer.

  State the APE (income tax) or period (sales tax) for which the payment was made. Also, give the correct APE or audit period to identify where this payment should be posted. If the payment is for multiple APEs or audit periods be sure to clearly identify the amounts and APEs or audit periods for which the payments should be applied.

  Request that a reply be sent confirming that the payment has been correctly posted.

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In the audit file, the auditor should provide a copy of the e-mail sent and copies of any replies received based on this e-mail.

As mentioned above, ACH Credit is the method of payment for audit liabilities. If the taxpayer is not able to use ACH Credit, the Treasurer's Office must be contacted for approval of a Wire Transfer. The auditor or Revenue Auditor Supervisor must contact the ROT Technical Review and Audit Perfection Supervisor for Sales Tax or the Income Tax Perfection Supervisor for Income Tax regarding Wire Transfers.

Please contact Technical Support with any questions concerning ACH Credit payments.

1.3.12 RECEIPT OF A SUMMONS OR OTHER LEGAL DOCUMENT

In order to preserve the Department of Revenue's legal rights, all personnel who receive a summons or any other legal document pertaining to Department business must notify a Supervisor of receipt. The document must be forwarded to the Director's office (Chicago or Springfield) immediately. Any summons received in regard to personal affairs such as jury duty, wage garnishment, etc., should be forwarded through normal channels.

1.3.13 INTERNET USAGE

State of Illinois computer systems are for government use and not for personal use. The policy of the Illinois Department of Revenue is to promote internet use that enables employees to perform Department missions and encourages its employees, volunteers, and contractor personnel to develop internet skills and knowledge. The entire IDOR Internet policy can be found on the Department's Sp-IDOR Web intranet under "Core Resources" - "Policy & Procedures".

The following Department users are covered by this policy:

- Full or part-time employees of the Illinois Department of Revenue.
- Volunteers who are authorized to use Department resources to access the internet.
- Department contractors who are authorized to use government-owned equipment or facilities.

When certain criteria are met, Department users are permitted to engage in the following activities:

- During work hours, access job-related information, as needed, to meet the requirements of their jobs.

- During working hours, participate in news groups, chat sessions, email discussion groups, and list servers, provided these sessions have a direct relationship to the user's job with the Department. Only those employees or officials who are expressly authorized to speak

to the media or to the public on behalf of the Department may represent the Department within any news group or chat room. Other personnel may participate in news groups or chat rooms in the course of business when relevant to their duties, but they must do so as individuals speaking for themselves and must include a disclaimer in their comments similar to the following: "This contains the thoughts and opinions of (employee name) and does not represent the official policy of the Illinois Department of Revenue."

RESTRICTIONS

The following uses of the internet, either during work hours or personal time, using Department equipment or facilities, are not allowed:

- Access, retrieve, or print text and graphics information which exceeds the bounds of generally accepted standards of good taste and ethics. For example, accessing, posting or sharing any racist, sexist, threatening, obscene, erotic and pornographic, or otherwise objectionable material (i.e., visual, textual, or auditory entity) is strictly prohibited.

- Engage in any unlawful activities or any other activities that would in any way bring discredit to the Illinois Department of Revenue.

- Engage in personal commercial activities on the internet, including offering services or merchandise for sale or ordering services or merchandise from on-line vendors.

- Engage in any activity that would compromise the security of any government host computer. Host log-in passwords will not be disclosed or shared with other users.

- Engage in any fund-raising activity, endorse any product or services, participate in any lobbying activity, or engage in any active political activity. Active political activity includes utilizing the internet in any fashion to promote or support a candidate for political office. This activity may be distinguished from accessing a web page that may be sponsored by a political organization in order to obtain information relevant to an employee's duties. For example, it is permissible to access the campaign web site of a member of the Illinois General Assembly in order to obtain information concerning a taxing proposal of the member.

- Employees must not intentionally use the internet facilities to disable, impair, or overload performances of any computer system or network, or to circumvent any system intended to protect the privacy or security of another user.

- Engage in any type of internet-based gaming activity.

It is expected that employees will use the internet as part of their official duties; to improve their job knowledge; to access tax, technical, and other information topics that have relevance to the Department; and to communicate with their peers in other government agencies, academia, and industry. Users should be aware that when access is accomplished

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using internet addresses and domain names registered to the Illinois Department of Revenue, they might be perceived by others to represent the Department. Users are advised not to use the internet for any purpose that would reflect negatively on the Department or its employees.

1.4 REVENUE AUDITOR STANDARDS AND PERFORMANCE EVALUATIONS

1.4.1 JOB KNOWLEDGE

Knowledge of duties and responsibilities as required for current job or position.

Standard: Utilizes accounting, auditing and financial skills to examine records, conduct interviews, develop facts, and prepare audit schedules. Displays knowledge in and keeps current with changes in the tax law, regulations, rulings, bulletins, and procedures. Has a working knowledge of independent research sources. Understands and fully develops audit controls. Displays knowledge and skills in computer functions, operations, applications, usage and management information systems to assure the proper examination of books and records. Demonstrates ability to understand business principles, law and operations in making decisions. Makes appropriate judgments which are based upon facts utilizing the skills expected for the position. Knows the duties and responsibilities as required for the current position and current developments that relate to the position.

1.4.2 PRODUCTIVITY

Amount of work generated and completed successfully as compared to amount of work expected for this job or position.

Standard: New, productive and significant issues are being raised and developed. Displays resourcefulness when developing issues and arriving at a correct determination of tax due. Makes valid audit referrals disclosing additional liabilities with appropriate documentation. Tasks and special assignments are accomplished with the desired results. Audit turnover is reasonable considering assignments. Hours on cases and the amount of work successfully completed when compared to others doing similar work and when compared to the objectives established.

1.4.3 QUALITY

Correctness, completeness, accuracy and economy of work.

Standard: Audits are technically and procedurally correct, using proper audit procedures and applications of the tax laws. Audits contain sufficient detail and work papers to show correctness of determination. The work product is neat, logical, clear, concise, and supports the conclusion and correctness of the determination. Work is logically organized and systematic with adequate cross references, detailing, labeling, and source identification. Necessary processing documents are included in the file and properly prepared. Areas of

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non-compliance have not been overlooked. Legal interpretations are appropriate and consistent with Department policy. Frequency of returned audits is within reasonable limits considering experience, complexity of assignments and level of audit turnover.

1.4.4 INITIATIVE

Self-motivation, amount of direction required, seeks improved methods and techniques, consistence in trying to do better.

Standard: Ability to be effective when working independently. Maintains updated audit manuals, bulletins, procedures, etc. Develops and utilizes independent research sources. Accepts diverse assignments with a positive attitude. Is adaptable and accepts changes. Contributes to the improvement of the Department operation. Demonstrates a sense of responsibility regardless of the assignment. Accepts and performs travel responsibilities as required and assigned in a timely manner. Takes steps to keep current with changes in technology and procedure changes when necessary.

1.4.5 USE OF TIME

Uses available time wisely—is punctual reporting to work—accomplishes required work on or ahead of schedule.

Standard: Ability to keep schedule full, keeping office time to an acceptable level. Audit schedules are necessary, suit the purpose intended and utilize Department developed programs whenever practical. Displays efficient utilization of audit time. Determines proper audit methods, techniques, and procedures to pursue in accomplishing audits, including means of verification, test periods, and extent of test checking. Spends time pursuing significant issues versus insignificant issues. Does not disrupt others when completing assignments in office. Individual is punctual and leave time is scheduled according to Department guidelines. Displays proper application of auditing tools and techniques.

1.4.6 PLANNING

Sets realistic objectives—anticipates and prepares for future requirements-establishes logical priorities.

Standard: Prioritizes assignments in accordance with Department guidelines or needs. Avoids excess aging of assigned cases. Exercises proper control over the statutes of limitations of cases assigned. Avoids excessive time lapses on work in process. Deadlines are established and monitored. Prepares adequate work plan to make a quality examination. Performs pre-audit research to ensure effective utilization of time on significant issues. Requests payment verification and compliance information so that completed assignments may be submitted without delay.

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1.4.7 FOLLOW-UP

Maintains control of workloads—allocates resources economically—insures that assignments are submitted timely and accurately.

Standard: Audits are timely submitted upon finalization with the taxpayer. Thorough audit history worksheets are in all audits submitted. Adheres to deadlines established in work plan schedules. Log in/log out sheets are completed daily. Submit timesheets and travel vouchers on a timely basis. Postings to the Outlook calendar are also timely. Accurately and completely documents all actions taken on each case. Document requests are included in the audit file. Written reports clearly state the facts, describe the circumstances and clearly reflect the Department's position and procedures used. Unusual items and items of any controversy are well documented and explained in detail. Completed work is thorough.

1.4.8 HUMAN RELATIONS

Establishes and maintains cordial work climate—promotes harmony and enthusiasm—displays sincere interest in assisting other employees.

Standard: Is courteous and helpful in personal contacts displaying a sincere interest in assisting others. Is neat in personal appearance and dressed appropriately for the situation. Valid complaints from others are infrequent. Employs effective personal communication skills which are successful in obtaining the desired results without unwanted confrontation. Exercises skill and control in stressful situations. Contributes to improvement of Department operations enhancing the image of the Department. Is a positive force in enlisting the cooperation of others in facilitating change. Displays a professional and ethical approach in interacting with taxpayers and other workers.

1.4.9 LEADERSHIP

Sets high standards—provides good managerial example—encourages subordinates to perform efficiently—communicates effectively.

Standard: Provides leadership by example. Exhibits the ability to plan, organize and supervise the activities of an assigned team of Revenue Auditors engaged in performing complex assignments. Exhibits the ability to accomplish tasks and accepts additional responsibilities to a high degree through cooperation. Makes sound and logical decisions. Has gained the respect and trust of fellow workers and taxpayers. Acts in a professional manner and instills the confidence of others. Employs two way communication skills listening as well as talking. Keeps superiors informed of critical issues and developments.

1.4.10 SUBORDINATE DEVELOPMENT

Helps subordinates plan career development—trains potential replacements—gives guidance and counsel.

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Standard: Cooperates in subordinate development and training. Shows a high degree of interest in helping others. Effectively functions as lead auditor. Acts as an instructor when required developing training programs, materials and making presentations. Supplies advice and feedback to others when necessary. Accurately evaluates and critiques the performance of trainees and assigned subordinates when asked. Needs of trainees and assigned subordinates are determined and action is taken to initiate personal growth and improvement. Encourages growth through open communication.

1.4.11 POLICY ON PERFORMANCE EVALUATIONS

It is the policy of the Illinois Department of Revenue and the Audit Bureau to conduct periodic, which includes quarterly and annual, employee evaluations on an employee's performance.

Written evaluations shall be prepared by the immediate supervisor and/or an employee in the same or higher position classification which has historically performed such evaluations who either has first-hand knowledge of the employee's work or has discussed and received recommendations from someone who does and reviewed by the ADM prior to discussing with the employee. The evaluation shall be limited to the employee's performance of the duties assigned and factors related thereto. The evaluation shall be discussed with the employee, and the employee shall be given a copy immediately after completion and shall sign the evaluation as recognition of having read it.

The performance evaluation will be reviewed and may be adjusted by upper levels of supervision. Any adjustments will be discussed with the employee.

The benefits of the evaluation process are as follows:

- The evaluation provides counseling helpful to the employee in becoming more effective and more valuable to the organization.
- It provides the basis for legitimate commendation and recognition; and
- It identifies goals and objectives that the employee and supervisor set together.

The Audit Bureau can improve the evaluation system by:

- Becoming more uniform in application of job standards;
- Reaching an understanding of expectations through communication between the supervisor and the auditor;
- Providing a means of recognition for work well done, and
- Helping an employee to improve in areas where necessary.

The forms to be used in the evaluation process are:

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- Performance Evaluation Form (CMS-201) and attachments
- Completed Audit Evaluations (EDA-72)
- Field Visitation Worksheet (EDA-73)
- Performance Improvement Plan memorandum (if applicable)

The evaluation process consists of the following steps:

- Set and communicate appropriate objectives.
- Prepare a list of objectives with employee. Discuss work objectives for the evaluation period.
- Approve plans of action for achieving work objectives and review with higher management.
- Review progress. Make adjustments as required. Provide coaching and assistance.
- Do quarterly reviews, providing feedback to improve performance.
- Evaluate performance and results for annual appraisal using form CMS-201 INDIVIDUAL DEVELOPMENT AND PERFORMANCE SYSTEM. Prepare list of objectives for next period.

Supervisors must follow the general guidelines on the CMS-201 in completing the evaluation. The supervisor and employee should complete the evaluation together and develop new objectives consistent with the needs of the employee and the Department.

The standards defined in Sections 1.4.1 through 1.4.10 describe the criteria on which a Revenue Auditor will be evaluated. Each supervisor is responsible for effectively communicating these standards to his/her staff members. Each standard is designed to provide the supervisor with objective measurable criteria from which the performance of the employee can be evaluated. Revenue Auditor IIIs will also be rated in areas 9 and 10 (leadership and subordinate development).

The evaluation process provides for the comparison of actual employee performance to an objective standard over the entire 12 month evaluation period. The supervisor’s work file should be examined along with other pertinent information. The auditor’s performance should be discussed in comparison to the standard and other specifics to arrive at a mutual understanding.

A field Revenue Audit Supervisor must document the auditors' performance on specific audit assignments during the year. There are two forms provided for these purposes: 1) Completed Audit Evaluation (EDA-72) and 2) Field Visitation Report (EDA-73).

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The EDA-72, Completed Audit Evaluation Worksheet, is to be completed by the supervisor on every audit assignment completed by the auditor. On team audits, assisting auditors should receive evaluations where significant time has been charged. The supervisor retains a copy and sends a copy to the auditor for review and to provide any comments about the evaluation.

The EDA-73, Field Visitation Worksheet, should be completed once a month in conjunction with all field visits to the auditors. The EDA-73 should be completed at the time of the visit. The auditor should sign the form and receive a copy. This is not intended to limit the documentation to field visits or completed cases. Field auditor Log in/log out sheets, timesheets, Audit Review correspondence, taxpayer questionnaires, e-mail and other documented communications, etc., should also be sources of documentation used for performance evaluations.

The EDA-72 and the EDA-73 should be included in the supervisor's file and not included in the completed audit file.

Exit evaluations are also conducted for auditors who are retiring or leaving the Department. The period covers the last evaluation date thru the date of retirement/exit.

1.5 ORGANIZATION OF THE AUDIT BUREAU

The Audit Bureau consists of a Program Administrator and three divisions, the Field Compliance Division, the Discovery and Recovery Division., and the Criminal Investigation Division (CID).

The Field Compliance Division is responsible for the Bureau's field activities related to Income Tax and Sales and Miscellaneous Taxes.

The Audit Discovery and Recovery Division is responsible for the Bureau's in-house activities related to Income Tax, Sales and Miscellaneous Taxes, CAA and Computer Support.

The Criminal Investigation Division (CID) is responsible for the enforcement of related revenue tax laws. Special agents handle a wide range of investigations, including those involving tax fraud, tax evasion, and other acts that circumvent revenue laws.

All three divisions report to the Program Administrator.

1.5.1 PROGRAM ADMINISTRATOR

The Program Administrator is responsible for the overall direction and performance of the Audit Bureau. The Program Administrator establishes, in conjunction with the Director and other divisions, the goals, objectives and staffing required to implement the Audit Plan and to administer the audit portion of the Department's tax enforcement programs.

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1.5.2 FIELD COMPLIANCE DIVISION AND DISCOVERY AND RECOVERY DIVISION

1.5.2.1 FIELD COMPLIANCE DIVISION MANAGER

The Field Compliance Division Manager is responsible for directing the activities of Assistant Division Managers and Revenue Audit Supervisors. The Field Compliance Division Manager is responsible for ensuring that the Field Division's activities comply with all statutes, regulations, auditing principles and legal opinions. The Field Compliance Division Manager is responsible for establishing Division goals and objectives which are required to meet the Departments' goals and objectives of its tax enforcement programs.

1.5.2.2 ASSISTANT DIVISION MANAGERS

Assistant Division Managers are responsible for planning, directing, and coordinating auditing activities of a geographical region within and/or outside the State of Illinois. They interpret the proper application of tax laws, rules and regulations, policies and procedures within their assigned areas of responsibility and ensure that supervisors and auditors are operating in compliance with them. Assistant Division Managers monitor and reassign work based on priorities established by higher level management. They also conduct conferences with taxpayers involving cases of a highly controversial or sensitive nature.

1.5.2.3 FIELD REVENUE AUDIT SUPERVISORS

Field Revenue Audit Supervisors plan, supervise and direct field audit staff engaged in auditing tax returns and tax records of taxpayers subject to one or more taxes administered by the Department of Revenue.

1.5.2.4 FIELD REVENUE AUDITORS

Field Revenue Auditors conduct audits of corporations, businesses, partnerships and individuals involving taxes administered by the Department of Revenue.

1.5.2.5 DISCOVERY AND RECOVERY DIVISION MANAGER

The Discovery and Recovery Division manager is responsible for the daily activities of the in-house Income Tax and Sales and Miscellaneous Tax support units. These units include, Audit Planning, Technical Support, Discovery, Federal and State Exchange, Computer and Hardware Support, CAA, Technical Review and Perfection and Clerical Support. The Discovery and Recovery Division Manager also oversees the duties of in-house Revenue Audit Supervisors as well as Revenue Auditors.

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1.5.2.6 IN-HOUSE REVENUE AUDIT SUPERVISORS

In-House Revenue Audit Supervisors supervise auditors conducting the following functions for Income Tax and Sales and Miscellaneous Taxes: post technical review activities, audit planning and selection, technical support, computer support and computer assisted audits.

1.5.2.7 IN-HOUSE REVENUE AUDITORS

In-House Revenue Auditors perform Income Tax or Sales Tax audit planning and selection activities, discovery activities, technical review of completed audits or technical support activities.

1.5.2.8 AUDIT PLANNING

The Audit Planning Sections, through utilization of the Audit Plan as their guideline, are responsible for carrying out the day to day operations of the audit planning and selection process. Selected taxpayers are evaluated to identify audit potential; if selected, they are assigned to the appropriate Revenue Audit Supervisor for assignment.

In areas where there are multiple supervisors covering the same territory, the audits available for selection will be pre assigned to the ADMs and will show in the ADMs' inventory.

Requests for audit assistance from other offices are to be forwarded to the appropriate Assistant Division Manager.

1.5.2.9 TECHNICAL SUPPORT

The Technical Support sections are responsible for keeping auditors informed of new policy issues, updated auditing procedures, issuing Audit Manual Updates, and updating Audit Manual chapters. Technical Support is responsible for answering requests for information and clarification on issues received from Revenue Auditors, Revenue Audit Supervisors, ADMs and other audit staff. The Technical Support sections are responsible for review of proposed legislation that would affect the Acts pertaining to their corresponding taxes. Proposed regulations and proposed private letter rulings are also reviewed. The Technical Support sections are also responsible for reviewing tax settlement cases prior to being presented before the Tax Tribunal or Administrative Hearings to ensure the audit was conducted according to Department policy and the tax liability is correct.

1.5.2.10 DISCOVERY

Income Tax Discovery reviews key information from returns filed due to Revenue Auditor's Reports (RARs) then perform additional research to determine if assessments should be

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issued. Auditors in the Income Tax Discovery section also conduct audits, complete special projects and Lead assignments.–

Sales Tax Discovery captures and reviews key information from transactional returns, customs reports, motor vehicle dealers/retailers, referrals, aircraft dealers, watercraft dealers, Secretary of State, and other resources to identify non-filers and under-reporting taxpayers. Auditors then perform additional research to determine if assessments should be issued. Sales Tax Discovery Auditors also conduct limited scope audits as well as traditional IFTA audits, special projects and Lead assignments.

1.5.2.11 FEDERAL AND STATE EXCHANGE UNIT

The Illinois Department of Revenue and the I.R.S. have entered into a Federal/State information exchange agreement to share certain income tax information on taxpayers. The Federal/State Exchange Unit identifies individuals who are under-filers or non-filers from IRS tape matches and issues Income Tax assessments on these individuals when appropriate.

1.5.2.12 COMPUTER AND HARDWARE SUPPORT

The Computer and Hardware Support section provides Audit Bureau staff with the required computer and hardware support. This includes maintaining and updating computer software and automated audit programs. It also includes the initial issuing of computer equipment and phones to new auditors, as well as, replacing broken equipment.

1.5.2.13 COMPUTER ASSISTED AUDITING (CAA) GROUP

The Audit Bureau position is that statistical sampling is the preferred method in large case auditing. Cases where the taxpayer has a large volume of transactions or the case took a large number of hours in the prior cycle, are prime targets for Computer Assisted Audit techniques (CAA). The goal of using CAA is to effectively utilize limited audit resources to produce more accurate and sustainable audit results. The Computer Assisted Auditing Group's function is to provide the auditor with the necessary CAA sampling information so that the auditor can complete the audit as quickly and accurately as possible.

1.5.2.14 REVENUE COMPUTER AUDIT SPECIALIST

Revenue Computer Audit Specialists provide extensive technical assistance to the Audit Bureau Staff by providing direction and guidance regarding specific situations involving computer assisted audit (CAA) methods and statistical sampling. They assist auditors in conducting highly complex tax audits involving computerized systems using special audit software. Revenue Computer Audit Specialists provide the auditor with the necessary CAA sampling information so the auditor can complete the audit as quickly and accurately as possible.

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1.5.2.15 TECHNICAL REVIEW AND PERFECTION

The Technical Review and Perfection sections are responsible for processing audit payments, reviewing submitted audit packages, inputting the required processing documents, issuing NTL's, NOA's, NOD's or claim denials and sending the completed audit packages to stores.

1.5.2.16 CLERICAL SUPPORT

This unit provides the Audit Bureau with support services which include mail delivery, data entry, file maintenance, etc.

1.6 AUDIT COVERAGE PLAN

On an annual basis, the Audit Bureau establishes a 3 year plan of desired audit coverage. This plan is intended to enhance voluntary compliance using a well-researched cross section of all taxes. The purpose of the plan is to allocate human resources and to assure representative audit coverage on a nationwide basis. The plan is developed using prior audit results and desired coverage levels to best utilize the available resources.
Data Analytics has been an increasing contributing source to the audit plan.

1.7 WORK HOURS AND REPORTING REQUIREMENTS

The Audit Bureau has established standard work hour schedules for both the in-house and the field staff. In-house staff also have the ability to request certain alternative work schedules that must be pre-approved by management using an Employee Alternate Work Schedule request form (RPS-72). These alternate schedules are not available for the field staff. In order to monitor the location of staff, to determine certain Bureau-wide production statistics for the Budget Office and to meet the requirements of the Fair Labor Standards Act, there are several reporting requirements that must be completed on a regular basis by employees. These topics are discussed in the following subsections.

1.7.1 WORK HOURS

- In House work hours are generally from 8:00 am – 4:30 pm, unless on a pre-approved alternative work schedule. There are optional four-day and nine-day schedules listed on the RPS-72 form. The employee may request one of these, but approval is contingent upon management's discretion. It will be based on whether the employee has a valid reason for being unable to work the standard hours, and how operational need is impacted by the alternate schedule.
- Field work hours are from 8:30 am – 5:00 pm. Deviations from these hours cost the Department money in lost productivity and resultsin Internal Audit findings.
  - If a taxpayer or their representative requests an arrival after 8:30 am, or departure prior to 5:00 pm, you must obtain a <u>written</u> statement from the taxpayer or

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representative requesting the deviations. This statement **must** be included in the audit file and scanned and attached to the audit in GenTax.

- The work day cannot be shortened for both the start time and the end time. The maximum deviation that can be requested by the taxpayer is a total of ½ an hour.
- Supervisors must be informed in advance if an appointment is not going to start until after 8:30 am, or if you must leave prior to 5:00 pm.
- The supervisor or ADM should contact the taxpayer to discuss the scheduling for the audit if the taxpayer cannot accommodate our work hours and requests deviations of greater than ½ an hour.
- Alternative work sites cannot open later than 9:00 am.
- Field work hours for **out of state** Revenue Auditors are 8:30 am-5:00pm. However, for the out of state auditors only, these hours can be adjusted if the travel commute exceeds approximately 1 hour or about 70 miles such that auditors would not leave their residence before 7:30 am. and would be expected to be home by 6 pm.

1.7.2 OUTLOOK CALENDAR - 30 DAY REQUIREMENT

Purpose: The Outlook Calendar is used to assist auditors in planning their work flow for the month. It is a readily accessible, up-to-date itinerary indicating the auditor's **physical location for appointments and contact numbers** throughout the day.

The following Memorandum of Understanding between AFSCME Council 31 and the Department of Revenue concerning the 30 Day Calendar Requirement for Audit Bureau was effective as of July 1, 2010:

1. The field auditors must maintain a monthly calendar in Outlook. The calendar must be completed for the following month by the 25th of the current month. Revenue Computer Audit Specialists and in-house personnel must utilize the calendar in Outlook when they have meetings scheduled or are scheduled to be off.
2. Supervisors will maintain weekly calendars in Outlook. The supervisors must complete their calendar for the following week by 12:00 PM on Friday of the current week.
3. Field auditors and supervisors are required to keep their calendar as current as possible. Timely and documented changes will not lead to discipline or downgrade to evaluations. If the auditor is going to change their work location during the current workday or if they are changing their work location for the following day after 3:00 PM of the current workday, the auditor must call their supervisor, next level of management, or designee to inform them of the calendar change before moving locations. Once at the new location, they will be responsible for updating their calendars as soon as practicable. If a change is required before 3:00 PM for the following day or a change is required for a future date in the month, the staff can make the change to their calendars without prior notification.
4. The calendar will be viewed as an itinerary, subject to changes. Field auditors are expected to plan their schedule and prepare their calendar accordingly. It is understood

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that last minute changes can and will occur due to cancelations by taxpayers or other issues related to audits. It is still a requirement to update the calendar as soon as practicable after becoming aware of the change.

5. Supervisors will have 3 business days from the 25th of the month to review field auditors' monthly calendars ensuring that the correct information appears on the calendar and to verify that each employee has completed the monthly calendar in a timely manner. ADM's will review supervisor calendars by 12:00 PM on Monday of the week. The following identifies the information that must be placed on the calendar in Outlook:

   a) Revenue Auditors
      a. Field appointments:
         Taxpayer's Name (Practitioner's/Attorney's Name)
         Address of Work Location
         Telephone Number
         Contact Person
         Auditor's Cell Phone Number
      b. Alternative worksite, this must be pre-approved per the alternative worksite policy and must include:
         Alternative Worksite Name
         Alternative Worksite Location
         Auditors Cell Phone Number
      c. If working at the office, the calendar must include the Taxpayer's names that the auditor is working on.

   b) Revenue Computer Audit Specialists
      a. Field Appointments:
         Auditor's Name that the RCAS is working with
         RCAS' Cell Phone Number
      b. Alternative worksite, this must be pre-approved per the alternative worksite policy and must include:
         Alternative Worksite Name
         Alternative Worksite Location
         RCAS' Cell Phone Number

   c) Revenue Audit Supervisors
      a. Field appointments
         Auditor's Name supervisor is visiting
         RAS' Cell Phone Number
      b. Alternative worksite, this must be pre-approved per the alternative worksite policy and must include:
         Alternative Worksite Name
         Alternative Worksite Location
         RAS' Cell Phone Number

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6. Questions regarding documentation to the 30 day calendar should be addressed with the Revenue Audit Supervisor or the Assistant Division Manager (ADM).

Please note: For field staff, since the purpose of the Outlook Calendar is to reflect the auditor's physical location for appointments, please do NOT use the Calendar as a listing all the audits the auditor is working on for the day, unless the physical location for the auditor changes. Allocation of hours on other audits should be done on the GenTax Timesheet. For example, Auditor is physically located at ABC Cake Shop for the day, but is waiting on the taxpayer to provide records. Since the auditor is unable to go further with the audit, he takes the 2 hours of wait time and finalizes his Auditor's Reports and Audit Narrative on 123 Car Repair Shop. The auditor's Outlook Calendar would only show the physical location of ABC Cake Shop since the auditor did not physically change locations. The auditor's GenTax Timesheet would show 5 hours on the audit for ABC Cake Shop and 2 hours on the audit for 123 Car Repair Shop. The auditor's Log In/Log Out should have a comment that they are physically located at track #A (for ABC Cake Shop) while working on track #B (for 123 Car Repair Shop).

1.7.3 RECORDING DAILY ARRIVALS AND DEPARTURES

The Fair Labor Standards Act (FLSA) requires that employers keep accurate records of hours worked by their employees. In order to comply with the FLSA, all Audit Bureau personnel are required to accurately record their work hours, overtime, compensatory time, etc. The procedures in the following subsections ensure that all Illinois Department of Revenue Audit Bureau personnel are in compliance with the FLSA.

Reference: Section 1.6 of the new Employee Handbook, IDOR Administrative Directive - Time and Attendance: Time Keeping, provides the details of the Department's policy on signing in and out.

1.7.3.1 IN-HOUSE STAFF DAILY TIME RECORD

Purpose: The Daily Time Record acts as the in-house staff's "punch card" for a true recording of their start/stop times as required by the FLSA.

In-house staff are required to physically sign in and out daily to record their arrivals and departures on paper Daily Time Record sheets. These are the official record of the times the employees start and stop work and are maintained by the Supervisor in their work area. Expectations for sign in/out include:

- The following times are to be recorded on the Daily Time Record: signing in at the start of the day, signing out for lunch, signing in after lunch, signing out at the end of the day, as well as any other in/out times during the course of the day as a result of using benefit time for partial days.
- Full day use of benefit time does not require sign in/out since a record is shown in e-Time.

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- Starting times should be the actual time (hour and minute) the employee arrives at the office. However, the initial sign in is not permitted prior to the start of the employee's work shift, unless on pre-approved overtime.
- Departure times should be the actual time (hour and minute) the employee leaves the work location. However, the sign out for the end of the day cannot be after the end of the employee's regular shift, unless on pre-approved overtime.
- Sign in/out for partial day benefit time must be the same as shown on the e-Time request.
- Sign in/out is not required for the morning or afternoon break periods.

1.7.3.2 FIELD AUDIT STAFF LOG IN/ LOG OUT SHEET

Purpose: The Log In/ Log Out sheet acts as the Field Audit staff's electronic "punch card" for a true recording of their start/stop times at the taxpayer location as required by the FLSA.

Since field staff are not located in an office on a daily basis to physically sign a paper record, an electronic method of recording start and stop times had to be developed. In order for field staff (field auditors and Revenue Audit Supervisors) to accurately report time usage through an electronic means, the Log In/ Log Out sheet located in the Audit Manager in GENTAX **must be completed on a daily basis**. The electronic entries for field staff are the equivalent to the paper Daily Time Record sheets required for in-house staff.

It is understood that there may be issues with connecting into GENTAX remotely. Therefore, if there are connection issues, log-in and log-out times should be recorded on paper and then transferred into GENTAX as soon as the auditor can establish connection. They must be completed no later than **by noon of the Monday (or first workday) of the following week. However, regularly completing an entire week of entries on Monday of the following week, without having a connectivity issue, is not acceptable. Daily completion is expected when there is no connectivity problem.**

Logging In:
Field staff **are required to use the Audit Log In/ Log Out** in GENTAX to report the time they start work on a daily basis, when returning from their unpaid lunch hour, and when returning to work after using unpaid time or benefit time.

The following factors must be taken into consideration when recording the log-in time in the Audit Log **In/ Log Out**:

- Normal field auditor work hours are 8:30 a.m. to 5:00 p.m.
- The time entered for log-in should be the **actual** time the auditor arrives at the work location. However, the initial log in entry is not permitted prior to 8:30 a.m., unless on pre-approved overtime.

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- Starting times should not be rounded. The actual hour and minute should be recorded.
- The log-in time when returning from benefit time (personal time, vacation time, sick time, etc.) must be the same time as shown on the e-Time request

Logging Out:
Field staff are **required to** use the **Audit Log In/ Log Out** in GENTAX to report any times on a daily basis that they ceased engaging in official business, such as when leaving at the end of the work day, starting the unpaid lunch period, or when leaving for absences due to doctor appointments, personal business time, etc. The end time must be recorded as the time work activities were ceased. Lunch and breaks may not be used to leave early. The end time must reflect the actual time that work was ceased, and may not be extended because the auditor did not take any breaks or lunch hour.

The following factors must be taken into consideration when recording the log-out time in the **Audit Log In/ Log Out**:

- The log-out entry at the end of the day should be the actual time the auditor leaves the work location. However, the log out entry at the end of the day cannot be after 5:00 p.m., unless on pre-approved overtime.
- Log-out for lunch break must reflect the actual time the lunch break started.
- Ending times should not be rounded. The actual hour and minute should be recorded.
- Log-out for benefit time (personal time, vacation time, sick time, etc.) must be the same time as shown on the e-Time request.
- Field staff are not required to log out for breaks.

Requirements for Comments:
When circumstances are different from the norm, comments are required. Below are numerous situations that require a comment in the Log In/ Log Out sheet. Comments are to be brief, but informative. The box has a limited number of characters that will display when the report is run in GENTAX.

- **Deviation from Normal Schedule**
  A comment must be entered in the comment box any time that there is a deviation from normal field work hours (8:30 a.m. – 5:00 p.m.). This includes such circumstances as when taxpayers have different business hours than our field hours, or when the auditor unexpectedly arrives late due to weather, heavy traffic, road construction, or re-routing due to an accident, etc.

- **Time Worked at an Alternative Site or at Home**
  A comment must be entered in the comment box whenever time is worked at an alternative site (AWS) or at home (WAH). If the AWS does not open at the start of

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your work day (8:30 AM) a note must be made as to the time the facility opened. Reminder: At no time may an AWS be used if it does not open until after 9:00 AM.

- **Benefit Time**
  If benefit time is used for a partial day, then the Log In/Log Out comment should reflect the number of hours and the type of time used (i.e. 3 hrs vacation). If full days of benefit time are used, for sick leave, vacation, personal time, etc. please make an entry in the comment box. One entry with applicable dates would be sufficient (i.e. vacation 7/3 through 7/7).

  Log In/Log Out sheets are generated at the beginning of each week for that current week. If benefit time is scheduled in advance, but within the current week, please record your comment in advance. (For example, on Monday you schedule a doctor's appointment for Thursday. The Log In/Log Out sheet is available on Monday to make your comment entry for Thursday that week.) This poses a challenge if you are scheduling your time in advance. Consequently, if your benefit time will occur in the future after the current week, or if it is unexpected so you are unable to enter it before you take it, please make the comment entry upon returning to work. (For example, on Monday you complete a vacation leave request for three weeks later. The Log In/Log Out sheet will not be available for you to enter your vacation comment since it is not generated until three weeks later.)

- **Work on a Different Audit**
  While an auditor should not visit the workplace of Taxpayer A with the sole intent on working on other audits, there are situations where work on a different audit is warranted. If the auditor is physically located at Taxpayer A, but exhausts all work on Taxpayer A's audit, or experiences delays in receiving audit data from the taxpayer, it is permissible to work on other audit work for up to ½ a day if the audit is a local audit. For this situation, a **comment is required** on the Log In/Log Out that the auditor is "Physically located at Track #A, but worked on Track #B." Make sure to use the track number rather than the taxpayer name. If it is a travel audit, the auditor should contact their supervisor for guidance on how to proceed if there are continued delays in receiving audit data for the taxpayer where the auditor is physically located.

LOG IN/LOG OUT EXAMPLES

Example 1: Taxpayer business hours different than auditors'

If the auditor arrives at the taxpayer's place of business and the business hours start at 9:00 a.m., log-in should be 9:00 a.m., with a comment in the comment box that the taxpayer's business hours are from 9:00 a.m. – 5:00 p.m.

Example 2: Late arrival

A taxpayer has business hours from 8:00 a.m. – 5:00 p.m. and the auditor was running late and did not arrive at the taxpayer's location until 8:45 a.m. Log-in should be at 8:45 a.m. with

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a brief comment that the auditor was late due to the specific reason such as “traffic delay,” “weather delay,” “re-route for road constructions”.

Example 3: Use of benefit time during working hours

An auditor arrives at the work location at 8:30 a.m. and logs in, but has to leave at 9:30 a.m. to go to a doctor’s appointment and then arrives back at the work site at 11:00 a.m. The auditor will log out at 9:30 a.m. and log in at 11:00 a.m. with a comment that the auditor had a doctor’s appointment for that time period.

Example 4: Travel

The auditor leaves his/her designated travel headquarters at 8:30 a.m. to travel to an out-of-state taxpayer and arrives at the taxpayer’s location at 1:30 p.m. The auditor will log in at 1:30 p.m. and make a comment that the auditor was traveling from 8:30 a.m. to 1:30 p.m.

Example 5: Changing taxpayers during day

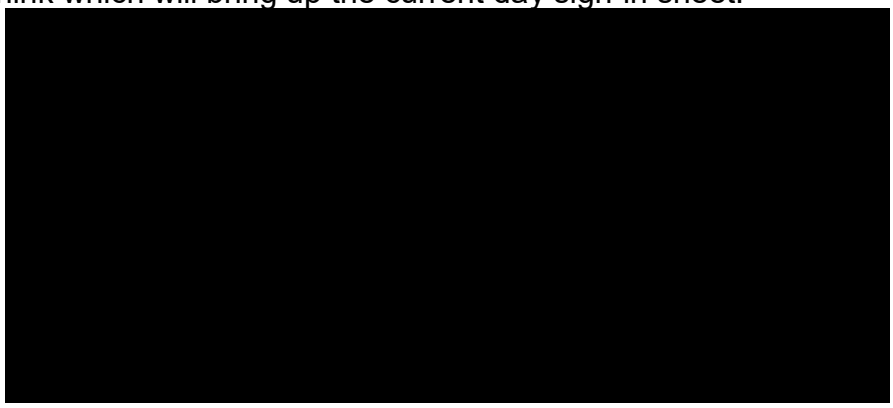
An auditor arrives at Taxpayer A’s location at 8:30 a.m. and logs in. Auditor leaves at 10:00 a.m. to go to Taxpayer B and arrives at Taxpayer B’s location at 10:30 a.m. The auditor does not have to sign out for this travel time, but has to comment that he/she changed taxpayer locations.

Example 6: Changing taxpayers during lunch hour

An auditor arrives at Taxpayer A’s location at 8:30 a.m. and logs in. Auditor leaves at 12:00 p.m. to go lunch, but will go to Taxpayer B’s location after lunch and arrives at Taxpayer B’s location at 1:30 p.m. The auditor will sign out for lunch at 12:00 p.m. and in from lunch at 1:00 p.m. The auditor will make a comment that he/she changed locations and arrived at Taxpayer B’s location at 1:30 p.m.

FIELD LOG IN/LOG OUT SHEET INSTRUCTIONS

The Audit Log In/Log Out manager is accessed from the My Work manager. Choose the Log In/Log Out hyperlink which will bring up the current day sign-in sheet.



Once this selection is made, the sheet for the current day appears:

To complete the sheet for the day, choose the change button at the top and all editable fields will turn green.

Once the fields are green, complete the necessary information & click the “save” button at the bottom of the screen.

Note: When entering times that are single digits, (i.e. 9:00 a.m.) be sure to enter the zero first. (Example: 09:00 a.m.)

If any Log In/Out sheets need to be entered for previous work days when the employee did not have access to GENTAX, or if an entry needs to be completed or changed, choose the “Prev Sheets” button at the top of the entry screen.

Click on the day needing to be changed or completed.

Click the change button.

After making the needed entries or changes, click Save.

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Field staff are responsible for ensuring that all Log In/Out sheets for the week are completed no later than noon of the Monday (or first workday) of the following week. Supervisors will be checking the Log In/Out sheets when verifying Time Sheets (formerly called Field Reports), e-Time leave requests and Travel Vouchers.
Field staff will have the opportunity to complete any missing Log In/Log Out sheets. If benefit time is used for a partial day then the Log In/Log Out sheet must reflect that time off.

Time sheets in GENTAX and Leave slips in e-Time should be consistent with the time reported on the Log In/Log Out sheet.

1.7.4 GENTAX TIMESHEETS

Purpose: The GENTAX Timesheet allocates the actual number of working hours spent to various specific direct or indirect activities, or to benefit time. These hourly allocation numbers feed into various managerial statistical reports which are used to provide information to the Budget Office, so they need to be as accurate as possible.

The Timesheet must be completed on a daily basis. It is accessed within GENTAX by using the ***My Work*** manager, the ***Audit*** navigation bar, and the ***Timesheet*** hyperlink. For each week's timesheet, there are individual ***Tasks*** that can be selected which are groupings for various in-house work locations, non-work, indirect, or direct time for specific audit assignments, Under these ***Tasks***, time is further sub-divided into ***Activity*** based upon the various types of work activities in that area. A separate timesheet is automatically generated for each week. The reports are due by noon on the first workday following the reported week. Once the employee completes and submits the timesheet, it is automatically assigned to their supervisor for review and approval.

1.7.4.1 NUMBER OF HOURS TO ACCOUNT FOR EACH DAY

Depending on the employee's work schedule, there will be different numbers of hours to account for on the GENTAX Timesheet. In addition, Timesheets do not take the morning and afternoon breaks into consideration because they are not spent working. In general, the full amount of working hours less breaks should be accounted for each day. Following are the specifics for each work schedule.

- Normal field and in-house five-day work shifts will account for 7 hours per day.
- In-House four-day work schedules will account for 9 hours on the long days and 8 hours on the short day.
- In-House nine-day work schedules will account for full day work hours less 30 minutes for breaks on all days, except the short day. The short day will account for a full day work hours less one hour (for breaks for the short day and breaks for the day off.)

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1.7.4.2 ACCOUNTING FOR NON-WORK HOURS

When completing the GENTAX Timesheet, non-work hours (time taken off) must be accounted for first. The time is recognized here so that this time off is not reflected as working hours in the statistical information that goes to the Budget Office. However, the time off is actually approved via e-Time as explained in Section 1.7.5. The actual number of hours of benefit time taken must be accounted for in the Timesheet, unless that number of hours exceeds the limits explained in the previous section for the number of hours to account for each day. In this case, the limit is used instead.

Under the Non-Work ***Type***, there are six ***Activities*** listed in the sub-spreadsheet: Comp/Hol, Holiday, Other, Personal Leave, Sick Leave, and Vacation. The last three are self-explanatory. The first three require some additional information.

- **Comp/Ho**l: This activity category is for compensation time that is used by any employee, or for earned Holiday time that is used by those on a four-day or nine-day work schedule for a day that is different from the scheduled holiday.
- **Holiday**: This is to record the time for scheduled State Holidays
  - Five-day work schedules account for 7 hours
  - Four day work schedules account for 7 hours, if the state scheduled holiday falls on the scheduled day to work. The remaining time balance for that day will be accounted for on one of the other applicable lines.
  - Nine-day work schedules account for required short day hours or required long day hours, if the state scheduled holiday falls on a scheduled day to work. On the long day, the remaining time balance will be accounted for on one of the other applicable lines.
- **Other**: This is used to account for miscellaneous time taken such as blood donor, jury duty, authorized leave, unauthorized leave, other paid time away, etc.

1.7.4.3 ACCOUNTING FOR WORK HOURS

After completing the Non-Work portion of the Timesheet, the remaining balance of the work hours to be accounted for should be allocated to the other ***Tasks*** that are related to work hours***.*** Within each of the work area ***Tasks***, there are sub-spreadsheets that require time allocation to the appropriate specific ***Activities***.

The following ***Tasks*** and their ***Activities*** are only used by appropriate in-house staffs:

- Audit Perfect – used by Audit Perfection staff
- Planning – used by both the Income Tax Planning and Sales Tax Planning staffs
- Inc Tax Disc – used by Income Tax Discovery staff. This will include direct time that is spent on leads from the Discovery Tool projects in Gentax conducted by the unit. If an employee works on more than one project or audit during the day, time must be accurately split between the various projects and audit assignments.
- Sls Tax Disc – used by Sales Tax Discovery staff. This will include direct time that is spent on leads from the Discovery Tool projects in Gentax conducted by the unit. If an

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employee works on more than one project or audit during the day, time must be accurately split between the various projects and audit assignments.
- Tech Support – used by Income Tax Technical Support and Sales Tax Technical Support staffs

The following ***Tasks*** and their related ***Activities*** are used by both field and in-house staffs:
- Supervisor – used by both in-house and field supervisors
- Indirect – used to account for working time not spent working on specific taxpayer audits or Discovery projects. It is used for such things as attending staff meetings, conferences, or training, researching issues, conducting union business as an elected union officer or steward, or "other" indirect activities such as a special project requested by management that is not tied to a particular taxpayer assignment. Anytime "other" is used, a comment is required in the Comment area. Do not use the note function of the Timesheet.
- Specific audit assignments added to the ***Task*** list through the ***Add Audit*** button: This is where most of the field staff's direct time and in-house direct time for traditional audits will fall. Timesheets must accurately account for the number of hours worked on **each** individual audit assignment. Field staff will use ***Add Audit*** to select their individual field assignments that they worked on for the week. In-house staff will use ***Add Audit*** for traditional audit assignments. Time must then be categorized under the proper ***Activity*** for that audit. If an employee works on more than one audit during the day, time must be accurately split between the audits. Do NOT simply record all of the hours on one audit for the sake of convenience. This skews the number of hours that are fed into statistical reports used for planning purposes.

1.7.5 E-TIME AND LEAVE REQUESTS

Purpose: The Illinois Department of Revenue utilizes the Electronic Timekeeping System (E-Time) which allows employees to manage and account for their benefit time and attendance records. E-Time is different from the GENTAX timesheets in that its focus it to account for the use and availability of benefit time, rather than account for the specific work activities that are conducted on a daily basis. It provides information for Personnel and for the Timekeepers.

E-Time enables employees to submit leave requests on-line for approval from their supervisors. It allows employees and managers to track time and attendance information in a consistent and automated format by providing centralized storage of time and attendance records. It also provides employees with information regarding benefit time usage and what benefit time is available.

1.7.5.1 CALL IN- LEAVE REQUESTS

Auditors are required to call their supervisor within the first hour of the assigned shift to report an absence for that shift. It is imperative when an auditor calls in to report his or her absence

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that the auditor talk to the supervisor or his or her designee, and not to any employee who happens to answer the telephone. The auditor must inform the supervisor or designee of the type of absence that is being requested (i.e. vacation, sick, personal or FMLA). Failure to timely report the absence could result in an unauthorized absence. A Leave Request is to be submitted via e-Time for the time and type of absence.

The procedures detailed in the Statewide Affirmative Attendance Policy will govern how unreported or unauthorized absences will be handled by the Department. This policy can be found under the Labor Relations area on the Department's intranet site.

1.7.5.2 ADVANCE LEAVE REQUESTS

Auditors and revenue audit supervisors must submit an E-time leave request to schedule vacation time and personal business time as far in advance as possible. An E-time leave request must also be submitted in advance for sick time when doctor or dentist appointments are known, or absence is required due to sick family, etc. Employees must e-mail their supervisor notifying them that time has been requested in E-time.

1.7.6 WORKING AT SITES OTHER THAN TAXPAYER'S LOCATION

Working at the taxpayer's location is the most efficient place to conduct a field audit. However, under certain circumstances field personnel may be allowed to work at their residence or an alternate work site after obtaining ***prior*** approval from management.

It is the Bureau's expectation that field auditors maintain direct audit time [redacted] in the field at taxpayer locations. Office time is to be kept [redacted] In our reporting environment, office time includes not only work in the office, but also alternative work site and work at home hours. Employees should monitor their office time to make sure they do not go [redacted].

Auditors are required to submit the **Request to Work at Home or Alternative Worksite** form to obtain prior approval to work at home or to use an alternate worksite. The **Request to Work at Home or Alternative Worksite** form is available on the Sp-IDOR web, under Work Areas/Audit/Forms.

The following sections outline requirements specific to working at residence or working at an alternative worksite.

1.7.6.1 WORKING AT RESIDENCE

Field personnel may be allowed to work at their residence upon obtaining prior approval from supervisors. Prior approval must be received **before** the workday commences. The immediate supervisor must give the approval. If the immediate supervisor is not available, the Assistant Division Manager must be contacted. Approval to work at home will only be given when it is in the Department's best interest. Therefore, supervisors and Assistant

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Division Managers retain the right to deny field employees the option to work at their residence, even if prior approval is requested.

Working at the office or at the taxpayer's location is the most efficient place to conduct Computer Audit Specialist duties. However, Computer Audit Specialists may also be authorized to work at their residence in certain circumstances upon obtaining prior approval from their supervisor. Approval to work at home must be received before the workday commences. If the Computer Audit Specialist's supervisor is not available, then the Audit Discovery and Recovery Manager must be contacted. Approval will only be given when it is in the best interests of the Department. Therefore, the supervisor and Audit Support Division Manager retain the right to deny Computer Audit Specialists the option to work at their residence, even if prior approval is requested.

Employees' work at home hours will be tracked on the weekly timesheet. If a request would result in an employee working at home for more than 28 hours in a month, prior approval must be received from the Assistant Division Manager or, in the case of Revenue Computer Audit Specialists, from the Discovery and Recovery Manager. Such requests should be submitted to the immediate Supervisor, if available. If prior approval is not received, the employee is not allowed to work at home for the time period requested.

The following procedures are to be followed for all work at home requests:

- The employee **must** receive approval prior to working at their residence. Typically this approval should occur prior to the day that the employee is requesting to work at home. The supervisor, Assistant Division Manager or Division Manager must forward the Work at Home Request form to the appropriate timekeeper with documentation that the request was approved and must 'CC' the requestor to document the approval.

- The Work at Home Request form must be completed and submitted for approval. The information that must be completed on the form includes the dates and times, the track number and name of the taxpayer for the audit to be worked on (multiple audits can be included by using the Special Considerations area for the track numbers and names of the second and subsequent taxpayers) and the reason for the request to work at home. The approving party may ask that the requestor identify the work to be performed on the track. This gives management an understanding of the work to be completed in order to determine whether the request is in the best interest of the Department.

- If the Request to Work at Home is done at the last minute due to unusual circumstances, then the requestor must receive oral approval from their supervisor, Assistant Division Manager or Division Manager prior to working at home and this oral approval must be documented on the Work at Home Request form in the 'Special Consideration' area. The Work at Home Request form must be submitted immediately upon your arrival at your residence.

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Under no circumstances should an employee work at their residence without prior approval from a Revenue Audit Supervisor, an Assistant Division Manager or Division Manager.

1.7.6.2 ALTERNATIVE WORK SITES

The alternative work site is not a substitute for your office, if you have one. If it is in the best interest of the Department to use the alternative work site, then management agrees that it is appropriate to do so. Most employees may need to use an alternative work site occasionally because of scheduling problems and the unavailability of their home or office space.

The alternative work site is a place that auditors can request to work at when research is necessary and required to complete an audit assignment or come to a conclusion on a specific issue. The alternative work site can also be used as a work location that is easily accessible to an auditor when he/she has completed all field-work regarding their taxpayer and are asked by that taxpayer to leave their premises. Although the alternative work site is available it should be stressed that every attempt should be made to remain at the taxpayer's place of business because of the confidentiality of the information we are working with and generally the business is a more secure environment for the auditor's work papers and equipment.

The alternative work site can also become a location to work at and re-locate to when appointments are cancelled by the taxpayer at the last minute and traveling to the field office would not be prudent in terms of productivity and cost. Lastly, the alternative work site can be used when your supervisor requests your presence to review any and all work related topics and a neutral meeting place is needed.

There is no basis to allow for a change in an employee's work schedule because they are working at an alternative work site. Normal work hours are 8:30 a.m. until 5:00 p.m. Beginning your day at an alternative work site that opens later than 9:00 a.m. is not acceptable. Remember, it is always important to use sound judgment when making decisions regarding working at locations other than the taxpayer's place of business, their representative's place of business or a Department office.

Multiple consecutive days at the alternative work site may not be appropriate or authorized. In these instances staff with an office should utilize these resources. If you do not have a field office or are remotely located from your office, these cases will be addressed on an individual basis and additional time may be granted. An individual's audit inventory, work assignments and work location may determine the amount of time that is requested to use an alternative work site. If employees are involved in audits of cash businesses or IFTA businesses, we recognize that these audit locations may not always be conducive to performing your audit work. For these auditors, it is expected that time at alternative work locations will be greater than other auditors and will be considered in approval decisions.

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If it is an employee's intention to work at an alternative work site, then this should be discussed with their supervisor and approved in advance. The employee will need to provide their supervisor the reason why they want to go to the alternative work site and the work that will be performed. When scheduling the alternative work site, the Work at Home/Alternative Work Site Request form must be completed and submitted for approval. Your supervisor should not learn that you have reported to an alternative work site via the calendar without their prior approval. This is not acceptable. If the employee does not receive approval or denial from their supervisor in advance, then you must receive prior approval from your Assistant Division Manager (ADM) or Division Manager if applicable. If prior approval is not received, the employee is not allowed to work at the alternative worksite for the time period requested. Approval will only be given when it is in the best interests of the Department. Therefore, the Supervisor and Assistant Division Managers retain the right to deny the employees the option to work at an alternative worksite, even if prior approval is requested.

If a situation arises and the employee needs to go to the alternative work site immediately, then they should call their supervisor to notify them and receive authorization. When these immediate situations arise and your supervisor does not answer your call, then you should leave a voice message describing your request and the name and location of the alternative work site you will be working. If your supervisor is not working on the day in question, then you need to contact your ADM. You must insure that your Calendar is adjusted reflecting the change in work location. You can either change your Calendar yourself or contact the appropriate office staff if one exists. It is important that your Calendar is always accurate and up to date. As in all situations, your Calendar should be adjusted prior to your changing locations or as soon as practicable. You should also send an email to your supervisor regarding your request as soon as possible supporting your phone request. It is important to remember that cell phones may not be permitted at the alternative work site so the employee will need to provide an alternative contact number so that they can be reached.

[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

A supervisor must take into account many different variables prior to approving an AWS or WAH request. Prior to giving consideration to time and cost efficiencies, the supervisor must ensure that the AWS meets the criteria for being a secure environment. A secure environment is one that ensures that confidentiality is not compromised.

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Ex: A private room that can be locked at a library or at any location would satisfy this Requirement. Work must be in a location where no one standing in the vicinity can view the employee's computer or documents.

FOR EXISTING AWS LOCATIONS: If the supervisor has not yet visited the location to ensure that it meets these requirements, a visit should be scheduled as soon as it is practicable.

FOR NEW AWS LOCATIONS: If at all possible, the supervisor should approve the location prior to its use. If that is not feasible, a visit to the AWS must be scheduled as soon as it is practicable.

NOTE: Utilizing the office of a POA, accountant or lawyer as an AWS for work *other than for the applicable audit* is not acceptable.

NOTE: A supervisor must confirm approval of the Alternative Work Site by sending an e-mail to the employee. The Supervisor must maintain these e-mails in the employee's Supervisor file for documentation.

When considering the request for AWS or WAH, the supervisor needs to ensure that there is a benefit to the Department by saving the State travel money or time; the request must be in the *"best interest of the Department."* Each of the following should be considered when making that determination:

What is meant by in the "*best interest of the Department*"?

- **Time efficient** – more Department work can be accomplished by working at an alternative work site or at home rather than commuting through traffic during work hours to the office.
- **Cost effective** – the cost of traveling to a location should be considered, as well as the cost of lost work time.

IMPORTANT: Each request must state the reason(s) why it is of benefit to the Department.

The following are examples of situations when AWS or WAH requests would normally be approved, taking into account the underlying principle that approval will only be given when it is in the *"best interest of the Department"* to do so.

Example Situations:

1. If the employee's work at the taxpayer's place of business will not take the entire day, a request for an AWS or WAH for the other portion of the day may be acceptable if you are closer to your home than the office. This would result in having more time available to work.

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2. If an employee is taking part of the day off, a request for an AWS or WAH for the remainder of the day may be acceptable.
3. If the taxpayer or POA makes a last minute cancellation and proximity to the office is not efficient, a request for an AWS or WAH request may be acceptable.
4. If an employee is remotely located, and they are participating in a staff meeting or a webinar, a WAH request is the only applicable option. Employees **must not** use AWS in these situations.

If a supervisor does not have an office (i.e. Dallas, Cleveland) the RAS may use an AWS to conduct a staff meeting. Acceptable sites would be a hotel conference room or another State of Illinois facility.

Request Requirements/Limitations:

- If the office is less than 30 miles from your residence AND it is for a FULL day, staff are required to go to the office.
- All Alternative Work Site and Work at Home requests must be approved in advance. The approval can be provided in an email from your supervisor. In those situations where immediate approval may be needed, you can obtain verbal approval from your Supervisor, Assistant Division Manager or Division Manager and note the verbal approval on the Alternative Work Site / Work at Home request when submitted.
- In all situations, the request must include information regarding what you will be working on. Sufficient explanation of tasks to be completed and track numbers should be provided to cover the number of hours to be worked. If the supervisor believes there are not sufficient tasks to be completed during the time requested to be worked at home, they will attempt to obtain additional documentation to cover the hours. If there are not enough tasks shown on the requests then the request will be denied.

Special Circumstance Requests: The following types of audits may be cause for approval of AWS and WAH requests. The Supervisor can approve blocks of time allotted for these special circumstances without interfering with the monthly 28 hour limitation for WAH requests.

1. Box or cash business audits with taxpayer records to be reviewed. Box audits are those where the taxpayer has no place for the auditor to work and the auditor is given hardcopy items to review by the taxpayer. These items may include invoices, receipts, ledgers, etc.
2. IFTA audits of trucking companies that may not have space for the auditor to review their records.

3. Travel audits or large taxpayer audits where taxpayers provide records to be brought back to Illinois or provide electronic records in response to IDRs.

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1.7.7 OVERTIME REQUESTS

Anytime in-state auditors drive in excess of 30 miles one way to an audit assignment, the auditor is granted overtime pay. Exceptions are as follows:

1) Travel to and from your designated work headquarters to another revenue facility.
2) Any travel in which per diem is claimed or allowed.
3) Trips to your designated work headquarters or another Revenue facility that are made other than your first or last stop of the day.

In order to calculate overtime, use the following formula:

Total Miles Driven Less Base Miles = Miles in Excess of Base	Miles in Excess of Base Total Miles Driven	= Excess Miles Factor

The above factor is then applied to the time it took to drive to the work location.

Driving Time Segment 1 + Driving Time Segment 2 = Total Driving Time	Total Driving Time X Excess Miles Factor = Base Overtime	Base Overtime Less Post 8:30 and Pre 5:00 time = Allowable overtime

An Excel worksheet application is available for auditors to calculate overtime. This application is in the Standardized Forms folder and is titled "Overtime Calculation Form". The calculated overtime must be reported on Form RPS-43, Overtime Report which is available on the Sp-IDOR Web under Core Resources/Forms/Human Resources Forms/ Timekeeping/Payroll. Any overtime that has been earned must be entered on form RPS-43 for the day in which it was earned. Anytime overtime is earned, the auditor must submit this form along with the corresponding travel voucher to his/her supervisor for approval. For timekeeping purposes, the actual overtime earned for a week will be rounded up or down in 7½ minute increments and posted to the last workday in the week earned. Form RPS-43, Overtime Report, is due weekly with the auditors' timesheets. A copy of the travel voucher for that time period is also needed to verify the time reported and the mileage.

Anytime an auditor is traveling to an audit work location after 8:30, he/she is not entitled to overtime from that point forward. The auditor is considered to be on the clock at 8:30 and must deduct any travel time after 8:30 from the base overtime calculation. If the auditor leaves before 5:00, the auditor must deduct the time left early from the base overtime computation.

NOTE 1: An auditor's normal work hours are 8:30 a.m. to 5:00 p.m. Overtime cannot be earned on leave time (vacation time, personal business, sick time, etc.) which causes the

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auditor to arrive after 8:30 am or leave before 5:00 pm. This time must be deducted from the base overtime computation for that day.

NOTE 2: Auditors may be required to do a cost comparison if the mileage to the audit site is significant. This cost comparison would determine if it is more economical for the auditor to stay overnight at the audit site or to drive there each day.

1.7.8 PREMIUM PAY REQUESTS

In-state auditors are entitled to out-of-state premium pay when they work more than 1 day on an out-of-state job assignment during an audit. The auditor must stay overnight at the out-of-state location to qualify for the premium pay.

Once the auditor completes the assignment, the auditor must complete form ACC-40, Out-of-State Premium Pay. This form is available in the Standardized Form folder on the laptop. The form consists of the number of days the auditor was at the out-of-state site and how many nights he/she is to receive premium pay. The form is submitted to his/her supervisor for review and upon verification, forward to the ADM or DM for final approval prior to sending it to the payroll office.

The auditor is paid the premium rate for the number of nights at a **rate of 15%** of the auditor's annual daily rate. The annual daily rate is calculated as follows:

Employees monthly salary times 12 = annual salary divided by 261 (# of work days in a year) = average daily rate times number of nights times 15% = gross amount of premium pay.

Example: Employees monthly salary of $3401 X 12 = $40,812 (annual salary) divided by 261 (# of work days in a year) = $156.368 (average daily rate) X 4 (number of nights) = $625.472 X 15% = $93.821 (gross amount of premium pay).

1.8 AUDITOR TRANSFERS

Employees desiring to transfer to a different office or work unit must complete a Request for Transfer, Form RPS-65, and forward it to Human Resources with a copy to the Division Manager's office. The request will be valid for two years. This form is available on the Sp-IDOR Web under Core Resources/Forms/Human Resources/Other. The Audit Bureau will notify all auditors of open auditor positions which might be filled prior to the posting of these positions. This will allow current auditors the opportunity to request a transfer to an open position. Human Resources will review all transfer requests on file and determine a position filling sequence by seniority.

1.9 TRAVEL AND TRAVEL TIME

It is the policy of the state of Illinois to reimburse employees for reasonable authorized expenses incurred by them in the performance of their duties. Travel should be done by the

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most economical options and transportation mode available, considering travel time, work requirements and overall expenses.

Since Audit Bureau employees spend significant amounts of time traveling, employees need to be aware that there are many rules in place governing how the travel should be authorized, how it should be conducted, and how reimbursement for expenses should be documented and requested. Below are the reference sources for the various rules that impact employees' travel:

- The Governor's Travel Control Board has established a ***Travel Guide for State of Illinois Employees*** outlining state regulations for travel. It is updated annually and can be found on the website for Central Management Services (CMS).
- In addition to the Travel Guide from CMS, the Department has its own supplemental policy called ***Travel Rules*** that gives guidance on items that are specific to IDOR. This can be found in the SpiDOR web under Items of Interest/Travel/Travel Rules.
- Forms for IDOR travel discussed in the following sections can be found on the SpiDOR web page under Core Resources/Forms/Travel.
- In the Exhibits at the end of the Chapter, there are examples of the various forms related to travel, as well as a helpful ***Travel Voucher Checklist*** that walks through the process step by step with the Department's automated travel voucher. This checklist can also be found on the SpiDor web under Work Areas/Audit/Audit Bureau Bulletins (in the Reference section)/Audit Bureau Bulletins/ABB-2017-3 Travel Voucher Checklist.

The following sections outline the process for travel approval, making travel arrangements, changing travel arrangements, documenting travel expenses, preparing the travel voucher, and submitting the travel voucher.

1.9.1 TRAVEL APPROVAL

Audit Bureau management requires prior approval for all overnight travel by Audit Bureau employees. Before overnight travel can be authorized, the following general rules must be taken into consideration by the traveler when planning:

- Travel should not take place during weeks when there is a holiday. However, if an out of state assignment cannot be scheduled during a different week, management approval is required before scheduling that particular out of state audit.
- All trips which require overnight lodging should be scheduled for full work weeks (Monday through Friday) unless specific approval for deviation is given by the supervisor in advance.
- Generally a two-week trip applies to out-of-state assignments covering great distances from the employee's residence. One week trips will be authorized when the cost for returning home is less than the cost of staying the interim weekend

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- Travel on authorized one or two-week trips will be on State time. Such travel should commence as close as possible to 8:30 a.m. on the first day of travel and end as close as possible to 5:00 p.m. on the last day of travel
- An employee must travel in the most cost effective manner.
- All travel in-state or out-of-state must be approved in writing on the authorized form prior to travel unless a specific emergency precludes and the appropriate verbal approval is given by the Program Administrator, Chief of Staff, or other delegate of the Director.
- If the traveler desires to return home during an interim weekend for a two-week trip, a cost comparison analysis must be made, and pre-approved. For approved trips home on interim weekends, the employee must attach a copy of the approval to their travel voucher, and they will be responsible for all expenses in excess of those which would have been incurred had he or she stayed near the jobsite. These trips will be made on the employee's own time and expense. It will be the responsibility of management to monitor travel time to assure the guidelines are followed. Managers may approve deviations when they deem the situation appropriate, but are not authorized to circumvent the Department's travel regulations
- An employee may be allowed to return home from an out-of-state assignment on state time and state expense if his presence at home is required due to a serious illness or death in the employee's immediate family. Once the employee reaches his home, he will be required to utilize accrued vacation, personal leave or sick leave to account for his absence from work. No overtime will be accumulated or credited for time spent in travel under this provision. For purposes of definition, the "immediate family or household" includes spouse, parent, sister, brother, child, or any relative or person living in the employee's household for whom the employee has custodial responsibility or where such person is financially and emotionally dependent on the employee. For bereavement purposes, that is for attendance at funerals, the term "immediate family" includes grandparents, grandchildren, parents-in-law, brothers- or sisters-in-law, and daughter- or sons-in-law. This expansion of term "immediate family" is for bereavement purposes only. Such trips must be approved by the Supervisor and a written explanation of the need for the trip must be attached to the travel voucher.

Management reserves the right to alter these general rules depending upon the worksite location, flight schedules, costs, length of assignment, and travel time.

Depending upon the type of travel needed, there are different forms that must be completed for authorization before travel can be conducted. These forms include the Travel Authorization, In-State Travel Request, the Out-of-State Travel Request, and the TAD-14 Attendance Request for Conference, Meeting or Training. They are each explained in the following sub-sections.

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1.9.1.1 TRAVEL AUTHORIZATION FORM

Purpose: To facilitate Audit Bureau management approval of **all overnight travel**. Aids in monitoring that the most cost effective methods of travel have been used.

Submission Date: At least **one week before travel**, and prior to finalization of travel arrangements.

Attachment Requirement: Not required to be attached to the Travel Voucher since this is an Audit Bureau form.

For **all overnight travel**, a Travel Authorization Form must be completed and sent to the employee's supervisor immediately after travel cost information has been obtained through the Department of Revenue's Travel Office. It is best to request authorization as far in advance as possible, but at minimum one week before travel. This form is required for all types of overnight travel without exception – auditing, attending hearings or court proceedings, attending training, conferences, meetings, etc. No employee is authorized to travel unless approval has been secured. Employees should contact their supervisor at least one week in advance of scheduled departure if they have not received the approved Travel Authorization Form returned from their supervisor.

Supervisors should review requests for travel, giving the following considerations:

- Is the travel being requested necessary?
- In the case of travel audits, does the potential of the case justify the costs of making the trip? In many cases, there is no prior history to judge audit potential and audit issues are not apparent from the taxpayer's filed returns. It may be necessary for some additional research to be completed prior to the trip. Good judgment should be utilized in approving trips in these instances. Travel to conduct audits should include the name of the taxpayer on the Purpose of Travel line(s).
- Is the trip being planned in the most efficient and cost effective manner considering travel time and the work required to be done?
- If an employee has requested to fly to a destination, would driving be more efficient?
- Is the hotel rate reasonable considering the location?
- If car rental is being requested, is it necessary?

Supervisors should contact the Travel Office to check alternative travel arrangements, if deemed necessary. It is not the intent of this procedure to make travel uncomfortable or inconvenient for our employees but to ensure that travel money is being spent efficiently and effectively. Supervisors needing help regarding whether to approve a trip should contact their Assistant Division Manager. The Division Manager should be contacted in the case of Audit Discovery and Recovery section supervisors.

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Supervisors should return the request marked either "Approved" or "Not Approved" and retain a copy for their files. When it is decided that a trip should not be taken, supervisors should initial the travel request at "Not Approved", note the reason in the comments lines of the form, return the form to the employee and retain a copy for their files.

When it is determined that a trip is necessary but travel arrangements should be changed, supervisors can do one of the following:

- return the travel request form to the employee and ask that appropriate changes be made and then resubmitted for approval
- make the changes on the request form, approve the travel as changed and return it to the employee with approval.

When completing the Travel Authorization Form, the following items must be submitted with the form:

- A printout from the Trip Cost Calculator on CMS's website to determine the most economical means of transportation. The calculator requires input of the number of days or hours and miles of upcoming travel. It then displays the associated costs. The calculator can be found at the following web address: http://www2/illinois.gov/cms/agency/vehicles/Pages/TripCostCalculator.aspx
- If the travel location is more than 60 miles from the employee's home, a cost comparison of all costs (mileage, hotel, per diem, etc.) for the trip is needed to justify whether it is more economical to stay in a hotel overnight, or to drive back and forth from the location. Cost comparisons should include hotels from the Preferred Hotel Listing on the CMS website. Rates for these hotels used in the cost comparison can be obtained through the Department's Travel Office.

A copy of the Travel Authorization Form can be found in the Standardized Forms folder on the auditors' laptops. See Exhibit A at the end of this Chapter for an example.

1.9.1.2 IN-STATE TRAVEL REQUEST FORM

Purpose: To encourage only essential in-state travel, this form used by all areas of the Department is required for approval through the supervisor, Program Administrator and the Budget and Planning Office to monitor the Department's travel budget.

Submission Date: At least **one week in advance** of travel, with approval granted before travel occurs.

Attachment Requirement: Approved form must be attached to each of the two copies of the Travel Voucher (Form C-10) that are submitted for reimbursement.

When an employee needs to travel outside his/her designated headquarters area, but within the state of Illinois on authorized state business, an In-State Travel Request must be

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completed. This form must be completed one week in advance for the following non-exempt situations:

- To attend staff meetings
- To attend Department training sessions
- To work at another IDOR facility, other than the employee's assigned headquarters facility

The In-State Travel Request form is not always needed for Audit Bureau employees. The following situations do **NOT** require the In State Travel Request Form because Audit employees have a blanket exemption for core/essential functions of the job:

- To conduct audit work on taxpayers
- To attend hearings, Court proceedings or litigation

This form is available on the Department's intranet website (the Sp-IDOR web) under the Core Resources/Forms/Travel Forms/Travel Requests. See Exhibit B at the end of this Chapter for an example.

1.9.1.3 OUT OF STATE TRAVEL REQUEST FORM

Purpose: To encourage only essential out-of-state travel, this form used by all state agencies is required to obtain approval from the agency Director and the Governor's Office of Management and Budget.

Submission Date: At least **42 days before departure (six weeks)** with approval granted before travel occurs.

Attachment Requirement: Approved form must be attached to each of the two copies of the Travel Voucher (Form C-10) that are submitted for reimbursement.

State business that involves out-of- state travel must have the Out-Of-State Travel Request form completed and approved by Audit management. This form must be completed when an auditor travels out of his/her state of residence for the following situations:

- Out-of-country travel **always** requires this form – **including** travel for the purpose of auditing
- Attending out-of-state staff meetings
- Attending out-of-state training sessions
- Working at an out-of-state office, if you are not assigned to that office
- Out-of-state travel that does not require an overnight stay (only Director approval needed. Governor's Office of Management and Budget approval is not needed.)

This form is NOT needed for the following out-of-state travel situations since Audit Bureau employees are exempt from filing the form for these core business functions:

- Auditing taxpayers (except for out-of-country)

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- Attending hearings or Court litigation

This form is available on the Department's intranet website (the Sp-IDOR web) under Core Resources/Forms/Travel Forms/Travel Requests. See Exhibit C at the end of this Chapter for an example.

1.9.1.4 TAD-14 ATTENDANCE REQUEST FOR CONFERENCE OR MEETING

Purpose: To obtain approval to attend an outside conference or seminar sponsored by an organization other than the Department of Revenue.

Submission Date: At least 42 days prior to departure (six weeks) with approval granted before attendance occurs.

Attachment Requirement: Approved form must be attached to each of the two copies of the Travel Voucher (Form C-10) that are submitted for reimbursement
When an auditor wishes to attend a conference, seminar, or training sponsored by an organization other than the Department of Revenue, the TAD-14 Attendance Request for Conference or Meeting must be submitted in place of the In-State Travel Request Form. The following steps should be completed:

- **Complete** Form **TAD-14**, Attendance Request for Conference or Meeting, and attach it to the program announcement for the conference, seminar, or training. This form should be submitted at least six weeks prior to the event,
- Complete and attach the Travel Authorization and Out-of-State Travel Request form (if appropriate). (If the event is in-state, the In-State Travel Request is not needed since the TAD-14 takes its place,)
- Obtain the approval of the Revenue Audit Supervisor and Assistant Division Manager,
- Submit the completed forms for Division Manager and Program Administrator's approval.

The completed approved request will be sent to the Human Resource Division for additional approvals.

The request will be returned to the auditor indicating approval or denial. The auditor is responsible for registration and travel arrangements.

The TAD-14 form is available on the Department's intranet web site (the Sp-IDOR web) under Core Resources/Forms/Training. See Exhibit D at the end of this Chapter for an example.

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1.9.2 MAKING TRAVEL ARRANGEMENTS

Cost information for travel arrangements should be obtained as soon as the employee is aware of a need to travel, so that the Travel Authorization Form and other appropriate forms can be prepared and approved in a timely manner.

All travel arrangements for authorized state business are required to be made through the Department's offices:

- The IDOR Travel Office makes arrangements for hotels, flights, rental cars, trains, etc. It is located on Level 6SW of the Willard Ice Building, or can be reached by calling [redacted] or emailing [redacted]. The Travel Office's mailing address is:

  Illinois Department of Revenue
  Travel Office
  101 West Jefferson, 6-515
  Springfield, Illinois 62794

- Pool cars are handled through the IDOR Motor Pool Coordinator of the Fleet Management Section of Operational/Special Services Division [redacted]

The Department has contracted to have a travel credit card for the Agency. This credit card is required to be used for most transportation and related expenditures (other than personal automobile travel or ridesharing services) as well as accommodations, unless an authorized exception has been granted. The credit card provides a means to directly bill the Department for the more significant expenses of state authorized travel. The Travel Office is the keeper and authorized user of the credit card. The individual traveler, however, is required to obtain receipts for the direct billed items and submit the receipts with their Travel Voucher for reconciliation to the credit card statement.

Employees must also send an email with attached copies of direct billing receipts (hotel, car rental, air travel, train) to [redacted] at REV. AuditTravelLiason @Illinois.Gov. It is a requirement by the Auditor General's Office that copies of all direct billed receipts are maintained by the Audit Bureau.

The following sections address various topics of concern when handling travel arrangements. **Refer to the State Employee Travel Guide from CMS, the Department's Travel Rules and the Travel Voucher Checklist in Exhibit E at the end of this Chapter for more specifics related to each topic.**

1.9.2.1 TRANSPORTATION ARRANGEMENTS

The CMS Trip Cost Calculator must be utilized to determine the most economical means of travel. The employee should travel by the most economical means as determined by the

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Calculator. Transportation can be arranged through the Travel Office for airline flights, rental cars and Amtrak trains. State owned pool cars are handled by the employee through Fleet Management as indicated above. Ridesharing services and personal vehicle transportation methods are handled directly by employees.

1.9.2.1.1 RIDE SHARING SERVICES

Taxicabs, shuttle vans, Ubers, and Lyft can be used when conducting state business if they are the most economical means of transportation. Arrangements for these services are made by the employee, and are not directly billed to the Department. Reimbursement of the cost is requested through the Travel Voucher.

In order to get reimbursed for Uber and Lyft ridesharing services, auditors are required to use the lowest cost services that car sharing services offer such as “Uber X” and Lyft Standard”. Auditors will not be allowed to claim reimbursement for rides obtained by using “Uber XL”, “UberSELECT”, “UberBLACK”, “UberSUB”, “UberLIX”, or”LyftPlus”. Further, auditors need to be aware that both services charge users more during times of high demand. Uber’s “Surge Pricing” and Lyft’s “Prime Time” can go into effect anytime there are a large number of users. Both Lyft and Uber will let you know in advance when prime time or surge pricing is in effect. Rides obtained during these higher cost periods are not reimbursable and if taken must be paid for personally by the auditor.
Reasonable transportation tips for cabs or shuttle vans will be reimbursed.

1.9.2.1.2 AIRLINE RESERVATIONS

The Department operates a fully automated in-house travel service that must be utilized by employees when making all flight reservations for authorized business travel. The Travel Office will make the travel arrangements through an on-line reservation system and will direct bill the airfare charges to the Department’s credit card. Individuals responsible for making group travel arrangements shall also contact the Travel Office for assistance. Reimbursement claims for travel arrangements which are not made through the Travel Office may be rejected or delayed. .

<u>Making Reservations</u>

- The employee should specify what time he/she is required to be at their destination.
- The reservationist will advise the employee of flights meeting this requirement.
- The employee may specify a particular flight desired.
- The reservationist, in consultation with the employee, will make every effort to book the least expensive flight, taking into account departure and arrival times, logistical considerations in the cities of origin and destination, and ticket restrictions.
- When booking travel, employees are expected to account for full work days. Deviations from this may be brought to the attention of the traveler’s supervisor by the Travel Office.

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- Employees must notify the Travel Office of any changes to travel plans.
- Employees must immediately report lost or stolen tickets to the Travel Office
- Non-refundable airfares will be booked only with the advice of the Travel Office management.

Ticket Delivery

The Travel Office does not deliver tickets. Tickets will be e-tickets which are stored in the on-line reservation system and the airline computer system. The employee will receive an e-mail which will provide the traveler with the required information and instructions on how to use the e-ticket.

Unused and Partially Used Tickets

- When reservations are cancelled and no portion of the e-ticket will be used, the traveler must notify the Travel Office no later than the next working day.
- Notify the Travel Office as soon as possible for any unused or partially used e-tickets so that credit can be obtained.
- If, per the instruction of the Travel Office, the employee purchased the ticket himself/herself and no portion of the ticket will be used, the employee shall be responsible for returning the ticket to the airline to receive credit.

  - When a ticket is partially used, the employee shall return the unused coupon(s) with the Travel Voucher (Form C-10), whether or not the employee is eligible for reimbursement of travel expenses. NOTE: The unused coupon(s) must be attached to the FRONT of the Travel Voucher.
  - Until partially used tickets are accounted for, any reimbursement due the traveler may be withheld. Payment is not made for partially used tickets until the credit for the unused portion appears on the airlines statement.

1.9.2.1.3 AUTOMOBILES

The Travel Office will make arrangements for rental cars if they are the most economical mode of transportation per the CMS Trip Cost Calculator. Agency owned pool vehicle or personal car arrangements are handled by the employee, if they are the most economical mode of transportation.

Rental Cars

- Travel Office arrangements for rental cars are directly billed to the Department, so employees must submit the rental car receipt with their Voucher.
- It is the employee's responsibility when renting the vehicle to waive the collision damage and personal accident insurance. These will not be reimbursed. The state of Illinois is self-insured. In the agreement with the rental car company, $1,000,000 liability protection is included in the rental rate.
- It is the employee's responsibility to inspect the renal before leaving the rental agency to ensure that all existing body damage is indicated on the agreement.

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- GPS rental or Toll Pass rental will not be reimbursed. They are the responsibility of the traveler.
- Parking tickets or traffic tickets will not be reimbursed.
- Fuel receipts must be submitted with the Travel Voucher.

Agency Owned Pool Vehicles

- Agency vehicles are maintained out of the Willard Ice Building for employees who require a vehicle on occasion for conducting state business.
- In order to use a pool car, the auditor is required to submit form OSD-155 "Request for Use of Vehicle" to his/her Division Manager for signature. The form can be found on the Sp-IDOR under Core Resources/ Forms/Request for Use of Vehicle OSD-155
- All arrangements for scheduling, pick-up and drop-off are handled through the Fleet Management Section Motor Pool Coordinator at [redacted]

Personal Vehicles

- Use of a privately owned vehicle requires that the employee certify on the travel voucher that he/she is duly licensed and carries at least the minimum required insurance coverage per the Travel Rules
- All travel must be by the most direct route. Expenses due to deviations for personal convenience are the responsibility of the employee.
- Reimbursement for the use of privately owned vehicles is on a mileage basis.

Reimbursable Transportation-Related Expenses to Note

- Automobile parking fees and tolls. Anything over $10 requires a receipt.
- Parking fees at a terminal or other parking area while the traveler is away from headquarters, but only to the extent that the fee plus mileage to and from the terminal does not exceed the estimated cost for use of a limo or taxi.
- Valet parking up to $30 per day. Anything above that amount must have an Exception Letter from the Travel Control Board.

Reporting of Vehicle Accidents

If an accident occurs involving a private vehicle while it is being used for state business, the insurance policy on the private vehicle is the primary coverage source. It is the responsibility of the auditor to ensure that the minimum required coverage is maintained. Liability amounts in excess of this primary coverage will be the responsibility of Illinois state government. A copy of any accident report (Form SR-1) and the Vehicle Accident Questionnaire (Form OSD-27) are to be sent to the Fleet Management Section **within 48 hours of the accident.** Drivers of any vehicle, whether privately owned, state owned, or leased, must have a valid driver's license.

If involved in an accident while driving on official state business, follow these steps:

1. Notify your insurance company as you would for any other accident.

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2. Obtain and complete Form SR-1, Illinois Motorist Report, from the Illinois Department of Transportation.
3. Complete IDOR Form OSD-27 (Vehicle Accident Questionnaire). This form is available on the Department's intranet under Core Resources/Forms/Vehicle Forms.
4. Prepare a brief narrative, in your own words, of the facts concerning the accident and attach it to Form OSD-27.
5. Mail original Form SR-1 to:
   Illinois Department of Transportation
   Accident Records Section
   3215 Executive Drive
   Springfield, IL 62766-0001
6. Mail a photocopy of all accident reports, including Forms SR-1 and OSD-27, **within 48 work hours** to:

   Fleet Management Section 1-116
   Illinois Department of Revenue
   101 West Jefferson
   Springfield, IL 62702

1.9.2.1.4 TRAINS

Arrangements for Amtrak must be made by the Department's Travel Office, if this is the most economical mode of transportation, and the train schedule meets the employee's needs. State employees receive discounted rates for travel between Springfield and Chicago during the work week. Advanced reservations are required to receive the state rate.

1.9.2.2 ACCOMMODATIONS ARRANGEMENTS

Arrangements for hotel accommodations must be made in advance (with sufficient time for preauthorization) through the Department's Travel Office. Accommodations charges are directly billed to the Department's travel credit card, and the traveler must secure a receipt to be submitted with their Travel Voucher.

The CMS travel rules require that the lowest available lodging rate be obtained when traveling on official state business. The State of Illinois requires employees who are traveling on official State of Illinois business to **first** contact hotels listed in the Preferred Hotel listing maintained by CMS when seeking overnight accommodations. The Department's Travel Office will do this when making arrangements. If the Travel Office has to secure a hotel rate that is over the allowable limit, they will secure an Exception Letter from the Travel Control Board which must be attached to the Travel Voucher. When the employee has an Exception Letter, the state will pay for the higher rate. For specific rules for permissible lodging at a

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hotel that is not on the Preferred Hotel Listing, please see the Department's Travel Rules Subsection 3: Accommodations.

Non-Reimbursable Accommodation Expenses to Note

- If the employee makes their own lodging reservations, reimbursement will not be made for any cost greater than what the State's Travel Guidelines allow. The Travel Office will NOT obtain an Exception Letter from the Travel Control Board for employees securing their own lodging reservations that are higher than the allowable rate.
- Lodging at headquarters or residence will not be reimbursed.
- If an employee chooses to upgrade their room they will be responsible for the additional cost above the allowable rate, or lowest rate available.
- An employee will not be reimbursed for lodging if he/she chooses to stay at a private residence of a friend or relative.
- While the on line marketing site Airbnb may at times offer lodging within or lower than the maximum lodging rate in certain areas, the State of Illinois will not reimburse employees who choose to obtain lodging through Airbnb while traveling on State of Illinois business.
- Late check-out and room guarantee charges are not reimbursable.
- Any charges in excess of the allowable lodging rate including such things as room services, restaurants, movies, personal phone calls, and other personal expenses must be paid by the traveler upon checkout. These are not reimbursable expenses.

1.9.2.3 CHANGES TO TRAVEL ARRANGEMENTS

Whenever changes need to be made to established arrangements that were secured by the Travel Office, the Travel Office should be notified to assist in the modifications.

Changes to airline tickets or lost tickets that incur a fee will need to have the Travel Office obtain an Exception Letter from the Governor's Travel Control Board which must be included with the Travel Voucher.

Changes to hotel reservations MUST be secured in a timely manner through the Travel Office. For early departure, the Travel Office can assist in eliminating any early departure fee, or obtaining an Exception Letter from the Travel Control Board if the hotel does not remove it. Cancellations should be made by the Travel Office to avoid being charged for a "no show" room. If the employee is unable to reach the Travel Office in a timely manner to make the cancellation, they must contact the hotel themselves to cancel before a cancellation fee is assessed. They should keep the cancellation number for verification and send a copy of the cancellation information to both REV.AuditTravelLiason@IL.gov and to the Travel Office. If the Travel Office was timely notified of the cancellation request and is unsuccessful in their request for the hotel to remove the fee, the Travel Office will obtain an Exception Letter from the Travel Control Board. This Letter is required to be attached to the Travel Voucher for reimbursement for the cancellation fee. If the employee fails to notify the Travel

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Office to cancel a reservation or does not cancel the reservation themselves in a timely manner when unable to reach the Travel Office, the employee will be responsible for the cancellation fee.

1.9.2.4 ARRANGEMENTS FOR MEALS: PER DIEM AND MEAL ALLOWNACES

Travelers are responsible for making their own meal arrangements. Depending upon the type of travel and the timing of travel, either a per diem rate or a meal allowance may be permitted to help cover the cost of meals while on state authorized business. For current reimbursement rates and specific rules for when meal allowances and per diem are allowable, please refer to the CMS Travel Guide Subpart E: Per Diem/Meals, and the Department's Travel Rules, Subsection 4: Reimbursements & Allowances.

1.9.3 RECORDKEEPING DURING TRAVEL

It is the responsibility of the traveler to maintain documentation and original receipts for all state-authorized travel. Receipts and documentation for authorized expenses are to be submitted with the Travel Voucher for justification of the reimbursement claim.

1.9.3.1 RECEIPTS AND DOCUMENTATION FOR EXPENSES

Following are examples common items that must be submitted with the Travel Voucher:

- Original receipts for any reimbursable item over $10 paid by the traveler (if smaller than 8 ½" x 11", must be taped to an 8 ½" x 11" paper)
- Original receipts for gas for rental cars, regardless of the amount
- Original receipts for direct billed items such as for lodging, rental car, airline tickets, and train tickets
- Exception Letters for such things as fees for changes to tickets, fees for cancellation of reservations, authorized hotel room rates that are above the state rate, etc.
- Missing Receipt Statements – if a receipt was not provided for an expense over $10, or it was lost, the employee can complete a Missing Receipt Statement to take the place of the receipt. See Exhibit G at the end of this Chapter for an example.

1.9.3.2 RECORDING TRAVEL TIME FRAMES

Travel time frames must be recorded on the Travel Voucher for each day, so the employee is responsible for accurately keeping track of these times. Departure times recorded on the Voucher for the start of the day should reflect the actual time the employee leaves their home or hotel. Travel Voucher arrival times at the beginning of the day should reflect the actual time the employee arrives at the destination. Departure times at the end of the day should be the actual time the employee leaves the taxpayer. Arrival times at the end of the day should be the actual time the employee returns home or to their hotel. Travel to obtain meals for

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lunch when meals cannot be procured at the taxpayer location should be separately stated on a line for "Vicinity" travel.

See Chapter 1 Section 1.7.3 Recording Daily Arrivals and Departures for how travel time frames should be recorded for purposes of other reports.

1.9.4 TRAVEL VOUCHER REQUIREMENTS

In order to receive reimbursement for authorized travel expenses, employees must complete a Department Form C-10 Travel Voucher. Following are some general points to remember when completing Travel Vouchers:

- Each travel voucher is limited to travel that occurs in the same calendar month. All trips on a travel voucher must have ending service dates in the same calendar month. Any trip that crosses over a month's end must be included on the next month's travel voucher.
- If the time frame of a trip requires two different voucher templates for different reimbursement rates, then the trip will need to be split into two vouchers based upon the templates for each rate.
- **Be sure to sign <u>both</u> copies of the travel vouchers**
- Direct-billed items must be indicated and deducted on travel vouchers. Supporting documentation must be attached.
- Original receipts for all reimbursable items must be attached.
- Required comments must be included in Box 30.
- Approved In-state Travel Request Form, Out-of-State Travel Request Form, or TAD-14 Attendance Request for Conference or Meeting must be attached.

The Department maintains a Travel Voucher form that is located on the Sp-IDOR under Items of Interest/Travel/Travel Forms. Make sure to select the Audit version as indicated by the word (Audit) in parenthesis. Also ensure the applicable version for the travel timeframe is utilized. New versions are created when reimbursement rates change.

1.9.4.1 TIMELY FILING OF TRAVEL VOUCHERS

Travel Vouchers must be filed **<u>TIMELY</u>** within the guidelines established by the Department. Both the Office of the Auditor General and the Department's own Internal Audit Division conduct regular audits of the Department's compliance with these guidelines. To avoid audit findings, make sure all vouchers are filed in a timely manner.

- Travel vouchers must be submitted to supervisors for approval and are required to be **in Springfield by the 15th (fifteenth) working day following the end of the month** in which the travel occurred, and
- Travel vouchers are due **in the Accounts Payable Division within 30 (thirty) days** after the end of the month in which travel occurred.

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- If your reimbursable expenses are less than $50, wait to the end of the month to submit a voucher, unless no further travel is anticipated within the month. A statement of such should be written on the voucher in Box 30.

Since the Audit Bureau has the unique circumstances of having staff dispersed across the country, we have challenges in meeting these requirements due to mail time. Despite this, we are NOT granted any extra time to account for mailing. Both Internal Audit and the Office of the Auditor General still require that we meet these timeframes. Accordingly, we recommend the following to prevent future audit findings in this area:

- Travel Vouchers should be submitted to the supervisor as close to the end of the month as possible. Make every attempt to submit it by the third day after the close of the month. If weekly vouchers are prepared, please submit them on a weekly basis rather than holding them until the end of the month.
- Supervisors should quickly review the vouchers and return them for any needed corrections. Make every attempt to sign the Travel Voucher and mail it to the Audit Bureau no later than the 15th day of the month (rather than the 15th working day of the month). The earlier the better, since it is not unheard of for mail to take 10 days to reach Springfield. This will allow some cushion for mail time, since the voucher must go through another step in Springfield before going to Accounts Payable.
- Once the voucher is received in Springfield, it must be entered into the Audit Bureau's travel voucher system. Then it can be sent to Accounts Payable by the 30th day after the end of the month.

1.9.4.2 TRAVEL HEADQUARTERS DESIGNATION AND MILEAGE LIMITATIONS

Employees must take two "headquarters" into consideration when completing their travel voucher. They serve different purposes, and must not be confused:

Office Headquarters Facility

The office headquarters facility is shown simply as "headquarters" on the Travel Voucher Box 6. It is the facility that the employee's position with the Department is associated with in our organizational structure. Following is a summary for the various scenarios.

- In-house employees – This is the city and state where the employee's work facility is located.
- In-state field employees – This is the city and state where the employee's office is located.
- Paramus, NJ – This is the Paramus, NJ facility if the employee's position was hired to report directly to the Paramus, NJ office. This does not include those hired to be resident field auditors reporting to a NJ supervisor (see the next dot point.)
- Out-of-state resident field auditor/supervisor – This is the employee's city and state of residence.

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Travel Headquarters

For purposes of completing the Travel Voucher, the travel headquarters is an important distinction since it plays a significant role in the amount of mileage that the auditor will be reimbursed. It is not necessarily the same as the office headquarters facility. The definition of an employee's travel headquarters designation was a part of an agreement between the Department and AFSCME on 06/01/1997. The following excerpts from that agreement define travel headquarters and mileage limitations:

- The parties agree that effective June 1, 1997, Revenue Field Auditors and Revenue Field Collectors shall have their home designated as headquarters for travel purposes only.
- Such Auditors and Collectors will not be reimbursed for travel expenses to or from their designated work headquarters, except for mileage in excess of thirty (30) non-reimbursable miles one way.
- The non-reimbursable miles traveled to and from the work headquarters will not exceed one hundred and eighty (180) miles per week.

It is understood by the parties that if an employee's residence or work area changes or if new employees are hired, the designation of travel headquarters will be dealt with on a case by case basis.

Given this agreement, the following will determine an employee's travel headquarters:

- In-house employees – This will be the same as the employee's office headquarters facility city and state since they are not field employees.
- In-state field auditors – This will be the employee's residence city and state.
- Out-of-state resident field auditors – This will be the employee's residence city and state.
- Out-of-state Paramus, NJ auditors – This will be the employee's residence city and state.
- Field supervisor with travel headquarters as home – This will be the employee's residence city and state.
- Field supervisor with travel headquarters as office – This will be the employee's office headquarters facility city and state.

Round Trip Commuting Miles (RTCM)

Travel regulations also require that round trip commuting miles (RTCM) from the employee's residence to the office headquarters facility be deducted in most situations from the total miles for reimbursement when driving a personal vehicle. Following will determine how RTCM will impact various employees on their Travel Voucher:

- Out of state resident field auditors and out of state resident supervisors have zero RTCM since their home is their office facility headquarters.
- In-state field auditors, out-of-state field auditors based from an office, CAA, and field supervisors (excluding out-of-state resident field supervisors) whose travel headquarters is their home must enter their RTCM from their residence to their office headquarters facility. They must only take RTCM into consideration when

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they travel directly to the office, or from the office directly to their residence. They will not be reimbursed for travel to or from their office headquarters facility, except for mileage in excess of 30 non-reimbursable miles one way, up to a maximum of 180 miles per week.

- All in-house auditors, in-house supervisors and field supervisors whose travel headquarters is their office must enter their RTCM based on their commuting miles from their residence to their office. Per the Governor's Travel Control Board Travel Update 15-02, as a result of an arbitration ruling all AFSCME Council 31 represented employees are exempt from the requirement that they deduct their ordinary commuting mileage from otherwise reimbursable mileage for days that they **DO NOT** travel through headquarters. Any AFSCME Council 31 represented employee seeking mileage reimbursement for days when he or she DID NOT travel through headquarters should clearly indicate on all relevant travel vouchers in Box 30 that he or she is represented by AFSCME Council 31. To be clear, the requirement to deduct commuting mileage for days where they **DO** travel to or from headquarters is still in effect for AFSCME Council 31 members. Employees that are not represented by AFSCME Council 31 must follow the Governor's Travel Control Board Travel Update 14-06. They will always be required to deduct the full amount of their RTCM, regardless of whether or not they travel through their headquarters.

1.9.4.3 CODES USED ON THE TRAVEL VOUCHER

There are two types of codes utilized on the Travel Voucher to which all expenses must be allocated. Expense Object Codes are utilized by Voucher Processing to classify information for the Budget Office so that the expenses related to each category can be tracked. Audit Bureau Codes are utilized by the Audit Bureau to further categorize expenses for our travel budget.

Expense Object Codes:

- Code 1291 – In-State travel of state employee. All travel in the state of Illinois is considered to be code 1291. It does not matter if the employee's position is based in another state.
- Code 1292 – Out-of-state travel of state employee. All travel outside of Illinois is considered to be code 1292.
- Code 1295 – Travel mileage.

Audit Bureau Codes

- Code 100 – Used for regular audit travel and travel associated with regional meetings, staff meetings, regional training classes and hearings.
- Code 200 – Used for travel associated with training or curriculum classes developed by the Audit Bureau, and meetings called by Bureau Management (currently only used for RAT classes)
- Code 300 – Used for travel associated with special assignments or projects directed by Audit Bureau management (i.e. Business Plan project teams)

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1.9.4.4 REQUIRED COMMENTS ON THE TRAVEL VOUCHER

There are many situations which require comments on the Travel Voucher in Box 30. Comments can also be made when there is need to explain or clarify specific charges. If the comments are not included, processing of the voucher can be delayed.

Following are some example situations:

- “Exempt from the in-state travel policy” must always be included when conducting audit related duties. This alerts Voucher Processing that the person is able to utilize the Blanket Exemption from the In-State Travel Request Form and provides justification for omitting it from the Travel Voucher when conducting a core audit function.
- Required when claiming mileage: "Please reference the agreement between AFSCME and IDOR travel policy for Revenue Auditors effective 06/01/1997 regarding mileage from their designated travel HQ (home) to work HQ."
- Normal work hours 8:30 am – 5:00 pm
- Rode with co-worker
- Stayed with family, friends
- Stayed at conference hotel (If lodging is over the allowable rate, this comment will replace the need for the Travel Control Board Exception Letter.)
- Dinner provided with conference on mm/dd/yyyy
- State pool vehicle used

1.9.5 TRAVEL VOUCHER CHECKLIST

Listed below in Exhibit F is a Travel Voucher Checklist. This Checklist has been developed to assist staff in the proper completion of travel vouchers. The Checklist is a reference document that outlines information relevant to Audit travel, and it walks through the electronic Travel Voucher completion indicating what is required for each box of the Voucher.

Please refer to this checklist and the Department Travel Rules when preparing your voucher to ensure you have completed it accurately. Managers should also refer to this checklist to ensure that vouchers are completed properly before approving and submitting for processing.

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EXHIBIT A: TRAVEL AUTHORIZATION FORM

TRAVEL AUTHORIZATION FORM

Traveler's Name _____

Purpose of Travel

_____

Destination _____

Travel Dates _____ **Estimated Travel Cost**

_____

Airline Information

Date	Airline	Flight #	Time	Origin/Destination
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

Total Cost of Airfare _____

Hotel/Motel Information

Name _____ **Phone number** _____

Address

_____

Cost Per Night _____**Number of nights** _____

Car Rental Information

Vendor _____ **Estimated Cost** _____

Others Using Car

_____

Other Expenses

Mileage Reimbursement [Estimate] _____

Per Diem _____**Other Costs** _____

Traveler's Comments:

_____

_____

--------FOR OFFICE USE ONLY--------

Approved: _____ **Date** _____

Not Approved: _____ **Date** _____

Comments:_____

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EXHIBIT B: IN-STATE TRAVEL REQUEST

ILLINOIS DEPARTMENT OF REVENUE
IN STATE TRAVEL REQUEST

Name(s) of Person(s) traveling:	
Date(s) of proposed travel:	
Headquarters:	
Destination:	
Purpose of travel: **(be specific)**	
Detailed Travel Expenses:	**Transportation:** $ ☐ airfare ☐ train ☐ car mileage ☐ state vehicle/pool car **Hotel:** $ **Per diem:** $ **Miscellaneous:** $ _____ **TOTAL EXPENSES:** $
Additional Information Necessary to Justify This Request :	

APPROVAL OF REQUEST

Approved	Denied	Date	Signature	
☐	☐	___/___/_____	_____	Immediate Supervisor

EXHIBIT C: OUT-OF-STATE TRAVEL REQUEST

STATE OF ILLINOIS
EXECUTIVE OFFICE OF THE GOVERNOR
GOVERNOR'S OFFICE OF MANAGEMENT AND BUDGET
SPRINGFIELD 62706

Bruce Rauner
GOVERNOR

OUT OF STATE TRAVEL REQUEST

Date of Submission: **Agency Name:** **Person(s) traveling:** **Total cost/person:** **Destination:** **Dates of Proposed Travel:**	
Agency Director signature:	**Date:**

Request must be submitted 30 days prior to travel. To be used in conjunction with restrictions placed on out of state travel. Please include the following information for all out of state travel requests.

1. **What is the purpose of travel for each person?**

2. **How is the travel critical to the agency's operations? What are the consequences if travel is denied?**

3. **Please provide detailed travel expenses by funding source.**

4. **Please provide any additional information necessary to justify the exception.**

5. **If this request has been submitted late to GOMB, please provide an explanation.**

FOR INTERNAL USE ONLY:

Circle One: Approve Deny **Approve Deny**

Governor's Office of Management and Budget Date **Office of the Governor Date**

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EXHIBIT D: TAD-14 ATTENDANCE REQUEST FOR CONFERENCE, MEETING, OR TRAINING

Illinois Department of Revenue

For HRD Use Only
Sub-A _____

TAD-14 Attendance Request for Conference, Meeting, or Training

File **all requests** six weeks in advance. **Form must be typed**

Step 1: Conference or meeting information

1 Attach copies of all attendance materials. (*i.e.*, program agenda, registration forms, attendee list)

2 Check the type of event. ☐ conference ☐ meeting ☐ training

3 Write the dates of travel. ___/___/___ (Month Day Year) through ___/___/___ (Month Day Year)

4 Tell us about the program and the sponsor.

a Program title _____ d Payee's FEIN ___ ___ — ___ ___ ___ ___ ___ ___ ___

b Program location _____ e Payee's name _____

c Sponsor _____ f Payee's address _____

5 Write the name, title, last 4 SSN, email address, and work area of each attendee. (If needed, attach an additional sheet using this format.)

Attendee's name	Title	Last 4 SSN	Email address	Work area

6 Why do you want to attend the conference, meeting, or training? (Specify agency benefits.)

_____

_____

_____

Step 2: Registration fees

7 a Is prepayment of the registration fees required? ☐ Yes ☐ No

b Is this whole amount being paid by Publicus Federal Grant Funds? ☐ Yes ☐ No

8 What is the registration deadline? ___/___/___ (Month Day Year)

9 Figure the total registration fees.

a Low fee rate (Date low rate ends ___/___/___ (Month Day Year)) $ _____ x ____ attendees = $_____

b Regular fee rate $ _____ x ____ attendees = $_____

Step 3: Estimated travel and overtime expenses

10 a Transportation ☐ Airfare ☐ Train ☐ Car mileage ($0.565 per mile) $ _____ x ____ attendees = $_____

b Hotel $_____ x _____ nights = $ _____ x ____ attendees = $_____

c Taxi to and from airport $ _____ x ____ attendees = $_____

d Miscellaneous expenses (tips, car rental, parking, etc.) $ _____ x ____ attendees = $_____

e Per diem* (**Not** paid for a quarter in which meals are provided) $ _____ x ____ attendees = $_____

f Will the event and/or travel to the event result in overtime? If so, what is the estimated overtime cost? $_____

g **Total travel and overtime expenses** (This figure does not include registration fees.) **Total** $_____

*The rate for out-of-state travel is $8 per quarter. The rate for in-state travel is $7 per quarter.
Quarters: 12 midnight to 6 a.m. — 6 a.m. to 12 noon. — 12 noon to 6 p.m. — 6 p.m. to 12 midnight

Step 4: Approval of request

11 Forward your request to the following individuals for approval. (Please obtain signatures in the order listed below.)

Approved	Denied	Date	Signatures	
☐	☐	___/___/___	_____	Division manager
☐	☐	___/___/___	_____	Bureau manager
☐	☐	___/___/___	_____	Program administrator
☐	☐	___/___/___	_____	Training Office
☐	☐	___/___/___	_____	Budget & Planning Office

TAD-14 (R-03/14) IL-492-3692

EXHIBIT E: EXAMPLE OF TRAVEL VOUCHER COMPLETION FOR A REVENUE AUDITOR TRAINEE

For this example, the Revenue Auditor Trainee John Doe was hired to be a resident auditor in Orlando, Florida, where he currently lives. To attend the Revenue Auditor Training Class that is being held in Illinois, he drives his car from his house to the Orlando airport a distance of 4 miles, and parks his car for the week at a cost of $50. After landing in O'Hare Airport, he picks up his rental car for the week to use while he is in training. He has other expenses of $19.59 gas for the rental car for the week, $50 airline baggage fees ($25 each way), baggage handling tips ($2.00 each way), and per-diem for his meals for the week.

Following are some special items to note when completing the travel voucher:

PURPOSE OF TRAVEL
The purpose of travel that must be used for Revenue Auditor training is "Revenue Auditor Trainee Training". This would be placed in Box 29.

AIRLINE TICKET
The airline ticket was $500 round trip. The total amount of the airline ticket must be shown on 3-10-17.

The airline ticket was direct billed. Please make sure to answer YES in Column 13A of the automated travel voucher. With answering YES it deducts the airline amount from the reimbursement received by the auditor.

Even though the airline ticket was direct billed the e-mail showing the direct bill charge for the airline ticket must be attached to the voucher.

RENTAL CAR
The State of Illinois has a rental car agreement with Enterprise that has a set rate per day for rental cars in Illinois and all other fees and taxes are waived. The receipt will show the daily rate in one area and then also show fees and taxes, but the fees and taxes are credited back to the Revenue account monthly.

On the travel voucher, only show the total daily rate for the rental car.
The rental car total was $186.45, but the daily rate was $32.
$32 x 5 days = $160.00.

The total daily rate for the trip was $160 and must be shown on 3-10-17.

The rental car was direct billed. Please make sure to answer YES in Column 13A of the automated travel voucher. With answering YES it deducts the rental car amount from the reimbursement received by the auditor.

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Even though the rental car was direct billed the Enterprise receipt showing the direct bill charge for the rental car must be attached to the voucher.

If the auditor rented a GPS, this could **not** be included on the voucher because the charges for a GPS are not reimbursable.

The auditor must make sure to re-fuel the vehicle before returning the rental car. No reimbursement is permitted if Enterprise re-fuels the vehicle.

LODGING

Lodging per day must be shown on the travel voucher. In the example voucher, the lodging rate was $137 per day plus $23.84 in taxes. So the amount being shown each day is $160.84.

The lodging was direct billed. Please make sure to answer YES in Column 14A of the automated travel voucher. With answering YES it deducts the lodging amount from the reimbursement received by the auditor.

Even though the lodging was direct billed the hotel receipt showing the direct bill charge for the lodging must be attached to the voucher.

See the example of the completed example voucher on the next page.

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State of Illinois
Form C-10
Disposition of Copies
1 Comptroller
2 Agency
3 Traveler

Travel Voucher FY 17

Illinois Department of Revenue
AUDIT BUREAU
101 WEST JEFFERSON
SPRINGFIELD, IL 62702

Payment of Interest may be available if the State fails to comply with the State Prompt Payment Act 30 ILCS 540

FOR EMPLOYEE USE ONLY
S/A - **0152**
RTCM - **10**
TRAV. HQ. **Orlando**

1 Social Security Number: **XXX-XX-1230**
TIN Type 02

2 Traveler Name and Address (Payee)
LAST NAME **Doe** FIRST NAME **John** MIDDLE INITIAL **S**
400 LAKE ROAD
ORLANDO **FL** **32789**

3 Voucher No
4 Voucher Date
5 Appropriation Account Code
6 Headquarters Orlando
7 Residence Orlando

8 Date	9 Departed From Place	Time	10 Arrived At Place	Time	11 Auto Mileage	12 Auto Reimb	13 Trans	14 Lodging	15 Meals/ per Diem	16 Other Expenses Item	Amount	17 Line Totals
03/06/17	Orlando, FL Home	6:00am	Orlando Airport	6:10am	4	2.14				Baggage Handling	2.00	4.14
	Orlando Airport	8:00am	Chicago, IL	10:00am						Airline Baggage Fee	25.00	25.00
	Chicago, IL	10:30am	Des Plaines, IL	11:00am				160.84	21.00			21.00
03/07/17	Des Plaines, IL		Des Plaines, IL					160.84	28.00			28.00
03/08/17	Des Plaines, IL		Des Plaines, IL					160.84	28.00			28.00
03/09/17	Des Plaines, IL		Des Plaines, IL					160.84	28.00			28.00
03/10/17	Des Plaines, IL	4:00pm	O'Hara Airport	4:30pm			160.00		28.00	Gas for Rental Car	19.59	47.59
	O'Hara Airport	7:00pm	Orlando FL Airport	9:15pm			500.00			Baggage Handling	2.00	2.00
	Orlando FL Airport	9:45pm	Orlando, FL Home	10:00pm	4	2.14				Airline Baggage Fee	25.00	27.14
										Parking Airport	50.00	50.00
Avg. Mileage Reimb. Rate		$0.535	Non Reimbursed Miles			Direct Billed	-$660.00	-$643.36				

18 Exp Obj	19 Amount	20 State License Plate Number	21	22	23	24	25	Subtotals	26	
1291	202.59		8	4.28			133.00	<====>	123.59	260.87
1292										
1295	4.28									
27 Tot. Exp	260.87									

30 Traveler Comments/Explanations
RTCM 10
Code 100
Code 200 1,564 23
Code 300
Code 400

28 Total Amount====> 260.87

Please reference the agreement between AFSCME and IDOR travel policy for Revenue Auditors effective 06/01/1997 regarding mileage from their designated Travel HQ (home) to Work HQ.

29 Purpose of Travel

Training

Revenue Auditor Trainee Training

I certify that I am duly licensed and have insurance in the minimum amounts as required by Illinois State Law.

This certifies that the travel shown above was required by official duties of the traveler named to my personal knowledge, or as indicated by records submitted to me. If applicable, the reporting requirements of section 5.1 of "An Act to create the Bureau of the Budget" have been met.

I certify that, in accordance with Section 12 of "An Act in Relations to State Finance", the above amount is correct and just; that the detailed items charged for subsistence were actually paid; that the expenses were occasioned by official business or unavoidable delays requiring the stay at hotels for the time specified; that the journey was performed with all practicable dispatch by the shortest route usually traveled in the customary reasonable manner; and that I have not been furnished with transportation or money in lieu thereof for any part of the journey therein charged for.

JOHN DOE

Division Head, Supt , Chief — Date
Traveler Signature — Date
Approved- Agency Head — Date
Approved- Director of Central Management Services — Date

Copy 3 Traveler

EXHIBIT F: TRAVEL VOUCHER CHECKLIST

Note: the items with the symbol indicate that this item must be attached to the Travel Voucher.

Step 1: Before Traveling

Travel Authorization – proper forms completed as needed, approved before travel, and attached to voucher when it is submitted.

- In State Travel Request Form (Use for attending staff meetings, training session, or for working at an IDOR facilities other than your assigned headquarters facility. **Not** needed for auditing taxpayers, for hearings or for litigation for those whose title is exempt from the In-State Travel Policy. See the Department's Travel Rules.)
- Out of State Travel Request Form (also for out-of-country travel. Requires Director and Governor's Office of Management and Budget approval **42 days before departure**. If out-of-state and does not require overnight lodging only the Director's approval is needed. This form is **not** needed for auditing taxpayers, for hearings, or for litigation for those whose title is exempt from the In-State Travel Policy. However, out-of-country travel always requires use of this form, even when for the purpose of auditing. Also use for attending out of state staff meetings, training sessions, or for working at an out of state office if you are not assigned to that office.)
- TAD-14 (for requesting attendance at an external conference, meeting, or training. Must be submitted for approval **42 days before departure**.)

Travel Arrangements – All travel should be done by the most economical options and transportation mode available, considering travel time, work requirements, and overall expenses.

- Contact the Department of Revenue's Travel Office [redacted] to arrange for hotels, flights, rental cars, etc. Pool cars are handled through the Motor Pool Coordinator of the Fleet Management Section of Operational/Special Services Division [redacted]. The State pool car license plate must be included on the Voucher.
- If a hotel room that meets the required state rate cannot be obtained by the Travel Office, the Travel Office will obtain an **Exception Letter** from the Travel Control Board. Print this off and it must be attached to the voucher to allow for the excessive rate.
- Utilize Trip Cost Calculator on CMS's website to determine the most economical means of transportation: http://www2.illinois.gov/cms/agency/vehicles/Pages/TripCostCalculator.aspx The employee should travel by the most economical means determined here.
- If private vehicles are the most economical mode of transportation, all travel should be by the **most direct route**. You may run MapQuest or Google Maps to determine the route. Justification of a different route should be provided if a substantially longer

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distance route is used. Expenses due to deviations for personal convenience are the responsibility of the employee.

Step 2: During Travel

Changes to Arrangements

- Changes to airline tickets or lost tickets that incur a fee will need to have the Travel Office obtain an **Exception Letter** from the Travel Control Board. This must be included with the Travel Voucher.
- Cancellations to hotel reservations – (unused hotel room charges, early departure) Employees MUST notify the Travel Office to cancel a hotel reservation (or make the contact themselves) in a **timely** manner to avoid being charged for a "no show" room. Keep the cancellation number for verification. Send a copy of cancellation information to REV.AuditTravelLiason@IL.gov. If you made the cancellation yourself, send a copy to the travel office as well. An **Exception Letter** from the Travel Control Board must be attached to the Travel Voucher to be reimbursed if the hotel does not remove the fee. Otherwise, there will be no reimbursement for the cancellation fee.

Receipts

- Save all receipts for direct bill items. The **original** receipts must be attached to the agency copy of the voucher and a **copy must be sent to the Audit Bureau travel liaison** to complete monthly reconciliation of the credit card vendor statements. Receipts smaller than 8 ½ "x 11" must be taped to an 8 ½ "x 11" piece of paper:
  - transportation (airline, train, rental car)
  - lodging
  - gas for rental cars regardless of amount
- Save all receipts over $10 paid by the traveler. The **original** receipts must be attached to the agency copy of the Travel Voucher. Receipts smaller than 8 ½ "x 11" must be taped to an 8 ½ "x 11" piece of paper. If no receipt is provided, or if it is lost, then a signed statement from the employee certifying the details of the expense, purpose, date, and amount of the expense will be accepted.
- Remember what expenses will be reimbursed. Following are examples:
  - Reasonable baggage handling and storage tips
  - Reasonable transportation tips for cabs or shuttle vans
  - Automobile parking fees and tolls
  - Subway or bus fare
  - Only UberX and Lyft Standard with no Uber Surge Pricing or Lyft Prime Time (reference Governor's Travel control Board Travel Update #17-03)
  - Valet parking up to $30 per day. Anything above that amount must have an Exception Letter from the Travel Control Board.

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- Parking fees at a terminal or other parking area while the traveler is away from headquarters, but only to the extent that the fee plus mileage to and from the terminal does not exceed the estimated cost for use of a limo or taxi.
- Faxing or copying for business purposes (Note: this goes on a C-13 form instead of on the Travel Voucher)
- Where the nature and location of work at a temporary duty station are such that suitable meals cannot be procured there, the expenses of daily travel required to procure meals at the nearest available place shall be considered a necessary transportation. A statement of the necessity for such travel shall be noted on the voucher. (80 IL Admin Code 3000.610(c)).
- Laundry and dry cleaning of $30 or less for trips of seven or more consecutive days. Self-service laundry would require a signed and dated statement with charges and dates.
- Telephone calls for official State business (three minutes or less) to announce arrival, delay or change of plans, or to secure lodging. Must be reflected on hotel receipt per the Travel Control Board. (Reimbursement for these calls is not applicable to those with State cell phones).
- Weekend or other early departure travel, if a comparison of airline costs, plus per diem, hotel, etc. show a savings to the State. Submit comparison with voucher.

- Remember what expenses will **NOT** be reimbursed. These must be paid by the traveler. Following are examples:
  - Collision damage and personal accident insurance on rental cars.
  - GPS rental or Toll Pass rental
  - Uber XL, UberSELECT, UberBLACK, UberSUV, UberLUX, or LyftPlus, Uber Surge Pricing, or Lyft Prime Time
  - Alcoholic beverages
  - Coat check
  - Entertainment
  - Late checkout and room guarantee charges
  - Room upgrade costs above the allowable room rate
  - Movie rentals
  - Parking tickets or traffic tickets
  - Weekend or early departure travel for personal convenience
  - Expenses due to deviations for convenience
  - Where suitable meals are available in close proximity to the lodging or temporary duty station, there will not be reimbursement for travel to procure meals.
  - Lodging at a private residence owned by the employee, employee's friend or relative
  - Lodging at an Airbnb location

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Recording Travel Time Frames

- Travel Voucher Times
  - Vouchers should reflect the time the employee leaves their home, and arrives at the destination, and then when they leave the destination and return home. If on overnight travel, record the time you left the hotel, arrive at your destination, leave your destination, and return to the hotel.
  - Vouchers should also have a **separately stated line for "in vicinity" travel** such as for lunch purposes when meals cannot be procured at the temporary duty station, or to obtain dinner when on overnight travel.
- Log In/Log Out (LILO) Times
  - LILO must be completed daily to reflect the **actual** time that the employee begins working at the taxpayer's or other work location, leaves for lunch, returns from lunch, and leaves the taxpayer's or other work location at the end of their day. This is a requirement of the Fair Labor Standards Act.
  - LILO **must contain brief comments** if the employee starts at the taxpayer location or other work location later than their 8:30 AM start time, leaves the taxpayer's location or other work location earlier than their 5:00 PM end time, incurs a delay in travel, changes taxpayer locations, or utilizes a longer than customary driving route for a valid reason. Comments should be brief such as "weather delay," "road construction/re-routing," "location change," "accident delay/ re-routing," "shorter driving time than most direct route," "alternative site opens at 9:00 AM," "work at home," etc. Comments are also needed when taking benefit time off.

Step 3: After Travel

Timeliness of Travel Voucher Preparation

- Travel Vouchers must be submitted **TIMELY**. We do not want to incur any more audit findings related to untimely filing of travel vouchers. It is the Department's policy that the **supervisor must approve the travel voucher by the 15th working day following the end of the month** in which the travel occurred. **The voucher must then be submitted to the Accounts Payable Division within thirty (30) days after the end of the month.**

  Since the Audit Bureau has the unique circumstances of having staff dispersed across the country, we have challenges in meeting these requirements due to mail time. Despite this, we are **NOT** granted any extra time to account for mailing. Both Internal Audit and the Office of the Auditor General still require that we meet these timeframes. Accordingly, we recommend the following to prevent future audit findings in this area:

  - Auditors should have their voucher to their supervisor as close to the end of the month as possible. Please make every attempt to submit it by the third day after the close of the month. If you prepare weekly vouchers, please go ahead

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and submit them on a weekly basis rather than holding them until the end of the month.

- Supervisors should quickly review the vouchers and return them for any needed corrections. Please make every attempt to sign the travel voucher and mail it to the Audit Bureau no later than the 15th day of the month (rather than the 15th working day). The earlier the better since it is not unheard of for mail to take 10 days to reach Springfield. This will allow some cushion for mail time, since the voucher must go through another step in Springfield before going to Accounts Payable.
- Once the voucher is received in Springfield, it must be entered into the Audit Bureau's travel voucher system. Then, it can be sent to Accounts Payable by the 30th day after the end of the month.

Timeframe Included on the Travel Voucher

- If your reimbursable expenses are less than $50, wait to submit a voucher at the end of the month unless no further travel is anticipated within the month. A comment will be needed in Box 30 to indicate there is no further expected travel.
- Generally, only one month of travel should be included per voucher, unless you are on a trip at the end of the month. If your trip crosses over two different months, you must submit a separate voucher for only that trip that crosses over two months. All ending dates of travel must be in the same month.
- If your trip puts you on different voucher templates for different reimbursement rates, then you will need to split the trip into two vouchers based on the templates for the rates.

Completion of the Travel Voucher

The Department's automated Travel Voucher can be obtained on SPIDOR web page under the "Items of Interest" tab. Select the menu item for "Travel," "Travel Forms," and then select the appropriate Audit Travel Voucher for the period you are completing. **Make sure to select the Audit version as indicated by the word (Audit) in parenthesis.**

Personal Info Tab

Start your voucher completion with the **Personal Info tab**. **Make sure to use all capital letters for this tab**. Please pay careful attention to the information below on your headquarters, and travel headquarters, to complete them accurately so that we do not incur audit findings.

- **Social Security Number** – This box will automatically pre-fill **Box 1** of the final Travel Voucher. Use X's to mask the first five digits of your social security number. Enter the actual numbers for the last four digits.

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- **Name and address information** – enter your full name and full **personal mailing** address. This name must be entered "last name, first name." This box will automatically pre-fill **Box 2** of the final Travel Voucher.
- Headquarters (city) – This box will automatically pre-fill **Box 6** of the final Travel Voucher. **PLEASE VERIFY YOU HAVE FOLLOWED THE INFORMATION BELOW**:
  - In-house – this is the city and state where your work facility is located
  - In-State Field – this is the city and state where the employee's office is located
  - Paramus, NJ – This is Paramus, NJ if your position was hired to report directly to the Paramus, NJ office. This does not include those hired to be resident field auditors reporting to a NJ supervisor (see the next dot point)
  - Out-of-State Resident Field Auditor/Supervisor – this is your city and state of residence
- **Division or Area** – This should already show "Audit Bureau." If not, click on the Audit button. This will automatically prefill the heading of the final Travel Voucher.
- **Address, City, State, Zip** – This is pre-filled with the WIB information for the Audit Bureau for the heading of the final Travel Voucher. Do not change this.
- **S/A** – This is pre-filled with a number used by Accounts Payable. Do not change this.
- **RTCM** – List your round trip commuting miles (RTCM) to your headquarters facility. If you are an out-of-state resident field auditor or a resident field supervisor, you will not have any RTCM because your travel headquarters and work headquarters are the same. Enter zero on this line. All in-house auditors, in-house supervisors, CAA, Paramus NJ field auditors, Paramus NJ supervisors, in-state field auditors and in-state supervisors must enter RTCM based on their commuting miles to the office. See Box 11 instructions for further explanation on how RTCM is used. This will automatically pre-fill the RTCM field in the **FOR EMPLOYEE USE ONLY** box on the final Travel Voucher.
- **Travel Headquarters** – This field must be manually entered since Audit has some special rules for travel headquarters. It is not necessarily the same as your facility headquarters. This field will automatically pre-fill the TRAV. HQ field in the **FOR EMPLOYEE USE ONLY** box on the final Travel Voucher. **PLEASE VERIFY YOU HAVE FOLLOWED THE INFORMATION BELOW:**
  - In-house – this will be the same as your headquarters facility city and state.
  - In-state field auditors – this will be your residence city and state.
  - Out-of-state resident field auditors– this will be your residence city and state.
  - Out-of-state Paramus, NJ auditors – this will be your **residence** city and state.
  - Field supervisor with travel headquarters as home – this will be your residence city and state.
  - Field supervisor with travel headquarters as office – this will be your headquarters facility city and state.
- **Headquarters** – automatically fills in based on your Headquarters (city). No need to change this.

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- **Residence** – automatically fills in based on your residence city. No need to change this. This will automatically pre-fill **Box 7** of the final Travel Voucher.

Entry Sheet Tab

Next, move to the **Entry Sheet tab** on the automated travel voucher. There are a series of boxes at the top of the screen. Most of this will be filled out **after** you complete the details in the Travel Information Section. The only one to verify before entering the Travel Information section is to ensure that the correct fiscal year is listed in the "Fiscal Year" box.

Travel Information:

Start with the Travel Information section that requires your daily entries. Most of the boxes/columns on the Travel Voucher have a corresponding box/column on the Entry Sheet tab.

- **Box/Column 8 – Date:** Enter the month, day, and year of your first day of travel (01/01/16). The same date can be entered on multiple lines if you made several stops during the day, or had "vicinity" travel for lunch. A separate line is needed for "vicinity" travel. Leave a space between dates of travel for ease of review.
- **Box/Column 9 – Departed From:** Place: Enter city and state you departed from. Time: Enter the time of day you departed, including AM or PM.
- **Box/Column 10 – Arrived At:** Place: Enter city and state you arrived at. Time: Enter time of day you arrived, including AM or PM.
    - When traveling to the assigned office, the employee must make a separate entry on the travel voucher using the words "office" or "headquarters."
- **Box/Column 11 – Auto Mileage:** Use this box/column if you drove your personal vehicle. Enter the number of miles you drove your vehicle as indicated by your odometer or MapQuest/Google Maps. If you drove a state pool vehicle, took a plane, train, rental car, cab, subway or bus, **do not** enter anything in this box. Refer to Box 13 below.
    - Whole numbers must be entered here. Please round your mileage. If your mileage was 9.4 miles, you would enter 9. If it was 9.5 miles, enter 10 miles.
    - In general, employees seeking mileage reimbursement must deduct their ordinary round trip commuting mileage (RTCM), regardless of whether or not they traveled through headquarters. (See below for further explanation for Audit employees.) The applicable commuting mileage should be entered in column 11 "Auto Mileage Non-Reimbursable" of the automated travel voucher. The automated voucher will then deduct the RTCM from the total miles automatically.
        - Out-of-state **resident** field auditors and out-of-state **resident** supervisors will enter **zero** as their RTCM, since their home is their work headquarters as well as their travel headquarters.
        - In-state field auditors, out-of-state field auditors based from an office, CAA, and field supervisors (excluding out-of-state resident field supervisors) whose travel headquarters is their home must enter their

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RTCM from their residence to their headquartered office. They must only take RTCM into consideration when they travel directly to the office, or from the office directly to their residence. They will not reimbursed for travel to or from their headquarters, except for mileage in excess of 30 non-reimbursable miles one way, up to a maximum of 180 miles per week.

- All in-house auditors, in-house supervisors, and field supervisors whose travel headquarters is their office must enter their RTCM based on their commuting miles from their residence to their office. Per the Governor's Travel Control Board Travel Update 15-02, as a result of an arbitration ruling all AFSCME Council 31 represented employees are exempt from the requirement that they deduct their ordinary commuting mileage from otherwise reimbursable mileage for days that they **DO NOT** travel through headquarters. Any AFSCME Council 31 represented employee seeking mileage reimbursement for days when he or she DID NOT travel through headquarters should clearly indicate on all relevant travel vouchers in Box 30 that he or she is represented by AFSCME Council 31. To be clear, the requirement to deduct commuting mileage for days where they **DO** travel to or from headquarters is still in effect for AFSCME Council 31 members. Employees that are not represented by AFSCME Council 31 must follow the Governor's Travel Control Board Travel Update 14-06. They will always be required to deduct the full amount of their RTCM, regardless of whether or not they travel through their headquarters.

- Field employees will not be reimbursed for mileage to or from their designated work facility headquarters, except for mileage in excess of thirty (30) non-reimbursable miles one way.
- The total non-reimbursable miles traveled to and from the work headquarters for field employees will not exceed one hundred and eighty (180) miles per week. Once you have traveled more than the 180 miles per week to and from the work headquarters, you may claim the excess mileage to the work headquarters.

- **Box/Column 12 – Auto Reimb. :** This travel voucher box will automatically calculate based on your total number of miles driven (less RTCM) in box 11 times the auto reimbursement rate. No manual entry required. There is no field for this Travel Voucher box on the Entry Sheet tab of the automated travel voucher.
- **Box/Column 13 – Transportation:** Use this box only if you traveled by state plane, commercial airlines, rental cars, and Amtrak. If the transportation was direct billed, you must type YES in **column 13a.** If it was not direct billed, and you paid for it, type "NO" in column 13a. For other modes of transportation, see Box 16. For state pool car, see Box 20. For riding with another employee, see Box 30.

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Attach a receipt for direct billed or employee paid transportation.

- **Box/Column 14 – Lodging:** If lodging was direct billed, enter the dollar amount for the lodging expense. Enter "YES" in column 14a. If lodging was paid for by the employee, enter the dollar amount for the lodging expense. Enter "NO" in column 14a. If the employee did not incur lodging expense because they stayed with family, friend, etc, enter an asterisk in Box 14, and describe the situation in Box 30. For conference hotel lodging, see Box 30.
  - Lodging is not a reimbursable expense at headquarters or residence.
  - If an employee chooses to upgrade their room, they will be responsible for the additional cost above the allowable rate, or lowest rate available.
  - An employee will not be reimbursed for lodging if he/she chooses to stay at a private residence of a friend or relative.

  Attach a receipt for **direct billed or employee paid lodging** expense. Attach an exception letter if lodging cost exceeds state travel guidelines.
- **Box/Column 15 – Meals or Per Diem:** Enter the per diem allowance that you qualify for. Deduct the appropriate amount if any meal was provided. (Refer to Section 3000.500b of the Travel Guide for State of Illinois Employees.)
  - Meals and per diem are not reimbursable at headquarters or at residence.
  - Per diem shall be paid for travel that includes overnight lodging or is 18 or more continuous hours.
  - Per diem starts with the time the traveler leaves residence/headquarters and concludes when the traveler arrives back to residence/headquarters.
  - Per diem is based on a quarter system. Each quarter shall be 6 hours commencing at midnight, 6:00 am, noon, and 6:00 pm. One-fourth the allowance is allowed for each six-hour period.
  - Meal allowances are given when the traveler is on travel status, but is not eligible to receive per diem. The traveler must have worked at least 10 consecutive hours and worked at least two hours prior to or past their regular work day to be eligible for a meal allowance. Lunch is not a reimbursable expenses. If claiming breakfast or dinner allowances, please note your normal work hours in Box 30.
  - Receipts are not required to support meal allowances or per diem.
  - Meal allowance and per diem cannot be mixed on the same trip or day.
  - If meals are provided for conferences or meetings, the value of these meals must be subtracted from either the meal allowance or per diem. You must specify the date and what meal(s) were provided in Box 30.
- **Box/Column 16 – Other Expenses:** In the column that says "Item," describe the type of reimbursable expense being claimed. See previous section in Step 2 on Receipts for examples of allowable and unallowable expenses. List the amount of the expense in the "Amount" column. Box/column 16 is also used for other modes of transportation

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that are not direct billed or private vehicles. Examples include cabs, subway, buses, shuttle service, mass transit, etc. If you group items, please only group like items together. If the total for the group exceeds $10, but without any single charge exceeding $10, you must make a comment in Box 30. The comment should read "no single *charge* exceeds $10." In your statement, you must specify the type of charge such as toll, cab fare, or bus fare.

Attach all receipts for expenses in excess of $10.00. If a receipt is not available, a written statement signed and dated by the traveler certifying the type and amount of expense is required.

- **Box/Column 17 – Line totals**: the totals are calculated automatically for columns 12 - 16.

Top Portion of Entry Sheet Tab:
After entering all the Travel Information section, go back up to the **top** of the Entry Sheet page. The boxes at the top will help complete the rest of the travel voucher. The references to box/column numbers below correspond with the travel voucher. However, the Entry Sheet tab does not have these sections numbered.

- **Box/Column 18 – Expense Object:** This box is on the Travel Voucher to list the code numbers. There is no entry required in the automated Travel Voucher because code numbers will appear automatically. An explanation of the codes to be used are as follows:
  - Code 1291 – In-State travel of state employee. All travel in the state of Illinois is considered to be code 1291. It does not matter if your position is based in another state. Enter the portion of your expenses related to travel in Illinois.
  - Code 1292 – Out-of-state travel of state employee. All travel outside of Illinois is considered to be code 1292. Enter the portion of your expenses related to out-of-Illinois travel.
  - Code 1295 – Travel Mileage (automatically calculated by the voucher program based on the mileage entered. This is pre-populated into the box on the Entry Sheet tab.)
- **Box/Column 19 – Expense Object Amount:** The automated travel voucher addresses this box/column just above the Travel Information section near the top of the page on the Entry Sheet tab. After you have entered all your daily details in the Travel Information section, the program will pre-fill the total expense line, and the Code 1295 with any mileage reimbursement amount claimed. The remaining total to be accounted for will show just above the red words "You Must Enter Exp. Obj." The appropriate amount(s) will need to be manually entered next to code 1291 or 1292, depending on the type of travel that was conducted. If you have accounted for too much expense, the message will change to "Exp. Obj. is Too High." Corrections are then needed. If you have accounted for all of the expense amount, the message will change to "Exp. Obj. OK."

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- **Box 20 – State License Plate Number:** The automated travel voucher has a box on the Entry Sheet tab (above the expense object box) that requires the employee to enter the license plate number of any state vehicle that is used for this voucher. If you use a state pool vehicle, you must fill in this box.
- **Box 21 – Box 28** – these boxes automatically total on the automated travel voucher. There are no manual entry boxes on the Entry Sheet tab.
- **Box 29 – Purpose of Travel:** A manual entry will not generally be needed into the Purpose of Travel box located at the top of the Entry Sheet on the automated travel voucher. Instead, when dollar amount information is entered into the Traveler Comments/Explanation box next to the various travel codes, a corresponding automated message will automatically fill in a Purpose of Travel into Box 29 on the tb-Final tab. The total dollar amount that will need to be accounted for can be found just under the red words "Expense Code Amounts to be entered:" A running total will be kept as you allocate amounts to the various codes as appropriate. The message "You Must Enter Exp. Codes" will display until you have coded all the expenses. Once you have coded all of the expenses, the red message will change to "Exp. Code OK." If you allocate more costs than you have, the message will read "Exp. Code Too High." The codes are as follows:
    - Code 100 – Regular audit travel and travel associated with regional meetings, staff meetings, regional training classes and hearings. The purpose of travel message displayed on the tb-Final tab is "Auditing"
    - Code 200 – Travel associated with training or curriculum classes developed by the Audit Bureau and meetings called by Bureau management (currently used only for RAT classes). The purpose of travel message displayed on the tb-Final tab is "Training."
    - Code 300 – Travel associated with special assignments or projects directed by the Audit Bureau management (i.e. Business Plan project teams). The purpose of travel message displayed on the tb-Final tab is "Special Projects."
    - Code 400 – used for relocation costs. The purpose of travel message displayed on the tb-Final tab is "Relocation."
- **Box 30 – Traveler Comments/Explanations:** Use this box to enter any additional comments or explanations which will further clarify specific charges. No abbreviations or acronyms are allowed by the Comptroller's office.
    - If you are one of the following Audit Bureau titles, you will need to include a message that you are exempt from in-state travel form. By checking the box on the Entry Sheet (next to the purpose of travel box) that says "Exempt from In-State Travel Policy," this message will automatically fill into Box 30 in the voucher. You will not need to type it.
        - Revenue Audit Assistant Division Manager
        - Revenue Audit Bureau Manager
        - Revenue Audit Assistant Bureau Manager

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- Revenue Audit Division Manager
- Revenue Auditor Trainee
- Revenue Auditor I
- Revenue Auditor II
- Revenue Auditor III
- Revenue Auditor Supervisor
- Revenue Computer audit Specialist
- Revenue Special Agent Trainee
- Revenue Special Agent
- Revenue Senior Special Agent
- Revenue Special Agent Supervisors
- Bureau of Criminal Investigations Manager

➢ Examples of comments for other clarifications:

- Rode with co-worker
- Stayed with family, friends
- Stayed at conference hotel (Note: If lodging is over the allowable rate, this comment will replace the need for the Travel Control Board Exception Letter.)
- Normal work hours 8:30 am – 5:00 pm
- Dinner provided with conference on 9/01/2016
- State pool vehicle
- Delay due to weather
- "Please reference the agreement between AFSCME and IDOR travel policy for Revenue Auditors or Collectors effective 6-11-97 regarding mileage from their designated Travel HQ Home to work HQ." This message is automatically listed on the Audit version of the automated travel voucher.

- Review the completed voucher for accuracy by viewing it in the tb-Final tab.
- Print the voucher from the Entry Sheet tab by clicking on the "Print" button to the right of the Expense Object box.
- The voucher must be signed, dated, and submitted by both the traveler and the traveler's supervisor within the time frames outlined at the beginning of Step 3. Signatures must be original, in blue or red ink.

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EXHIBIT G: MISSING RECEIPT STATEMENT

MISSING RECEIPT STATEMENT

(All Information is Required)

TRAVELER NAME: _____

WHY NO RECEIPT: _____

_____

_____

_____

_____

_____

PURPOSE: _____
(i.e. parking, taxi, tolls, baggage fee, baggage handling, etc.)

AMOUNT: _____

DATE: _____

LOCATION: _____
(business, city & state)

"I SOLEMNLY SWEAR THAT THIS STAMENT IS TRUE AND CORRECT AND THAT I WAS ON OFFICIAL STATE BUSINESS"

_____ _____ _____
Traveler Signature Date

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Disclaimer

This audit manual is a guideline for assisting and training auditors in the completion of their audits. Every audit is an independent review of a particular taxpayer's books and records. Every audit requires cooperation from taxpayers. If the taxpayer fails to maintain or provide the books and records required by statute or regulation or fails to timely comply with any reasonable request for documents or additional information, the auditor is authorized to use any reasonable procedure or method necessary to obtain the information necessary to determine the correct amount of a tax liability and to apply his or her best judgment in making that determination.

The failure to follow a suggested procedure or method, deviation from a suggested procedure or method, or any additional investigation outside the scope of a suggested procedure or method is at the discretion of the Department and shall not be grounds for invalidating any audit finding. The Department reserves the right to review and revise the work of any auditor and to order or approve procedures or methods that deviate from or are outside the scope of this manual. The Department reserves the right to update, revise, or rescind this manual or portions thereof without notice.

Any references to statutes, regulations, case law, private letter rulings or general information letters are for background purposes for assisting the auditors. Nothing in this manual constitutes an official policy, legal position or interpretation of law sanctioned by the Department's Director, General Counsel or Legal Services Bureau.

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GENERAL AUDIT PROCEDURES

I. INTRODUCTION

This chapter is meant to be applied to all tax types and covers reasonable cause, amnesty, and procedures for technical support assistance and compliance checks.

It is the mission of the Illinois Department of Revenue to collect state and local taxes as authorized by Illinois laws, to assist as directed with the tax matters of other units of government in this state, and to administer tax related programs as assigned. To achieve this purpose, and to instill public confidence in the integrity and efficiency of the State's tax programs, the Audit Bureau will pursue the following goals:

- Encourage and achieve the highest possible degree of voluntary compliance with Illinois tax laws.
- Work for the adoption of tax laws that are fair, simple to understand, and cost efficient for both the Department and taxpayers.
- Accurately and efficiently collect, deposit, process, and allocate tax revenues.
- Establish clear, concise, accurate and timely communications with the public (taxpayers, legislators, practitioners, employees, etc.).
- Maintain a workforce that demonstrates the highest standards of integrity, efficiency, and performance.

II. TECHNICAL SUPPORT

A. AUDIT TECHNICAL SUPPORT ASSISTANCE

1. GENERAL INFORMATION

During the course of an audit, auditors may encounter situations where they are unsure whether the taxpayer is properly following the applicable laws and regulations. Before discussing the issue with the taxpayer, auditors can request guidance from the respective Technical Support Section on how to proceed.

Below are the procedures for requesting that guidance:

1) The first step for the auditor is to research the issue by reviewing the available reference materials such as the audit manual, regulations, statutes, previous Technical Responses, etc.

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2) If the auditor is unable to resolve the issue on their own, the next step is to discuss the issue with their supervisor. The supervisor should also research the issue to see if they can find a solution.
3) If the supervisor is unable to discover a solution, the next step is to discuss the issue with their Assistant Division Manager (ADM). The ADM will work with the auditor and supervisor to identify whether they have enough information to make a decision or should request guidance from the Technical Support Section.
4) If it is determined that guidance is needed from the Technical Support Section, the supervisor should forward the information to the respective Technical Support Supervisor explaining the issue and describing the research conducted up to that point. The supervisor should carbon copy the ADM.
5) The Technical Support Supervisor will review the submitted information and then assign it to an appropriate Technical Support Section auditor for further research.
6) The Technical Support Section auditor who receives the assignment should contact the auditor to discuss the situation and should then conduct further research. If necessary, they should discuss the issue with the Legal Services Bureau.
7) After completing their research, the Technical Support Section auditor should formulate an answer and present it to their supervisor for approval.
8) If the answer is approved, the Technical Support Supervisor will forward the response to the field auditor and supervisor.
9) The field auditor and/or supervisor should use the guidance received from the Technical Support Section when discussing the issue with the taxpayer. If the taxpayer disagrees with the guidance, the issue will be evaluated and a determination will be made as to whether a formal Technical Request is warranted. If it is determined that a TR is necessary, auditors should follow the procedures for obtaining a Technical Request.

B. TECHNICAL REQUEST PROCEDURES

1. PURPOSE

A request for technical support should be submitted in order for the Department to reach a proper defendable position for the proposed audit

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issue(s). These are not to be used in place of research by the auditor and supervisor.

Before submitting a technical request, you must advise the taxpayer that you will be doing so and provide them the opportunity to provide their position on the issue to include with the request; the taxpayer will be given a 2-4 week timeframe/deadline to provide their position. They will also be granted the ability to review the technical request you create to ensure they agree that the issue is framed properly and that their position is also included properly; again, a reasonable timeframe/deadline should be given to the taxpayer to review the technical request in order not to delay the process.

You will provide the taxpayer the decision reached on the issue(s) and some explanation, but you do not provide the technical response memo. You may provide the legal provisions provided with the technical response to the taxpayer and use as support in your audit documentation.

The technical memo that is created to respond to the question is a discoverable item and will be made available during any litigation if requested. As a result, it is important to be cognizant of this in crafting the original technical request as well in the technical response.

2. TECHNICAL REQUEST SUBMISSION

The request for technical assistance must be in memo form. This memo is written by the auditor. As noted above, the taxpayer will be allowed to review the memo and provide any support for their position on the issue. The Auditor must document in the EDC-5 when their memo was provided to the taxpayer, when the Auditor requested the Taxpayer's position memo, when they received the Taxpayer's position memo, and the date that the Technical Request was sent to Technical Support. Document that the taxpayer has reviewed and agreed that we have properly framed the questions and issues. Also document when the response was received from Technical Support and when Taxpayer was informed of the decision as stated in the Technical Request.

The auditor will submit the completed technical request and the taxpayer's position memo to their supervisor. The supervisor will forward to the Technical Support Supervisor, to log the request and initiate the internal processes. The supervisor should carbon copy the ADM.

The Technical Support Supervisor will request confirmation from the supervisor that the taxpayer was allowed to provide their support for the

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position on the issue and that they have agreed that the memo has properly framed the issue from their perspective. If the supervisor is unable to provide that confirmation, the technical request will be rejected until the request can be submitted with the proper confirmation by the supervisor.

3. REQUIRED INFORMATION

The following must be included in the submitted request:

- Taxpayer name
- Account ID
- Audit ID number (Track number)
- Statute date
- Audit periods
- Issue to be researched/addressed
- Relevant attachments – spreadsheets, taxpayer documentation, such as invoices, contracts, taxpayer's explanation, etc., that are important to the audit issue. Do not attach every document from the audit file.

A technical request must be submitted with sufficient statutory timeframe remaining to allow for the request to be properly analyzed and addressed to give an accurate response. You should request any waivers necessary to have sufficient statutory time before submitting the request. You will remain responsible for ensuring statutes are protected. If we are unable to secure a waiver, we will need to determine if the issue should be included in the audit or not.

Specific questions should be submitted concerning the audit issue(s). Care should be taken with the language used in the request, since the taxpayer will have access to the document.

4. TECHINCAL SUPPORT TIME FRAME

Once the request has been assigned, the Technical Support Auditor should formulate a response and have it submitted for approval, within the procedural 60 day time frame. Under certain circumstances, the time frame needed for approval may be extended. The response time frame includes:

- Research of the audit issue

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- Response write-up and possible meeting with Legal Services Office
- Approval by Legal, the Technical Support supervisor and Division Manager
- Distribution and placement on Sp-IDOR

Note: When formulating a response, Technical Support Staff should never refer to "draft" regulations as support for a determination/conclusion in the write-up of a technical request.

5. POST-REQUEST RELEASE

[redacted]

- [redacted]
- [redacted]
- [redacted]

However, the auditor may do the following:

- Provide the taxpayer with the supportive authoritative provisions (whether from the Statutes, Department regulations, court decisions, etc.) that the Technical Request states. A copy of the actual technical response should **NOT** be given to the taxpayer.
- Utilize and reference the supporting authoritative provisions (whether from the Statutes, Department regulations, court decisions, etc.) that a Technical Request provides, for the defense of the audit position. Stating those supportive provisions is allowed in the EDC-5 or Auditor's Comments, where warranted.

6. WHEN TECHNICAL REQUESTS ARE NOT ALLOWED

A Technical Request should not be submitted if:

- The auditor has issued the ICB letter;
- ICB has accepted jurisdiction of the audit case; and/or
- The audit is in litigation (Administrative Hearings, Tax Tribunal, or Court).

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In such cases, statutory support for the Department's position will be obtained by other means.

III. COMPLIANCE CHECKS

The uniform compliance approach, in general, is to assure that any taxpayer under audit is in compliance with all tax laws (both State and Federal); not just the tax presently being audited. Compliance checks should go back for **six** years. The six years applies to the actual current date not to the audit year(s).

Note: Any request to audit further than the six-year look-back period must be approved by the Assistant Division Manager (ADM) or the Division Manager (DM) for all tax types.

When completing an assignment, the auditor must determine and document that the taxpayer is properly filing returns under all appropriate tax laws administered by the Department and that there are no open periods. When the taxpayer is someone other than an individual, it is also necessary to determine whether the partners, beneficiaries or shareholders (in the case of a closely held corporation) are in compliance with Illinois' tax laws. All non-filing entities and individuals uncovered during compliance checks must be brought into compliance if the potential liability (which includes tax, penalty, and interest) is determined to be over the [redacted] tolerance. If a gross or intentional lack of compliance for a tax which is not being audited is found, make a referral by completing an SC-137, audit referral.

During the opening conference, the taxpayer should be informed that a compliance check of the business (unless unitary) and the owners (partners, shareholders, etc.) for all taxes administered by the Department (Income, Sales, Withholding, etc.) is a required part of the audit. The auditor must obtain copies of the Income Tax returns (both Federal and State) at this time.

If the required tax returns have not been filed, the Auditor should firmly encourage the taxpayer to prepare the returns and submit them before the close of the audit. If the taxpayer does not comply, the Auditor will refer the account to the Income Tax Audit Planning section for the review and possible establishment of an audit by filling out the SC-137.

A. TAX TYPES FOR VERIFICATON

The Department's uniform compliance approach requires that the Audit Bureau personnel verify individual income tax filing of all partners, shareholders, officers and sole proprietors during the course of routine audits of businesses.

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The auditor will apply the Uniform Compliance Approach to the following taxes:

- Business Income Tax (BIT)
- Withholding Tax (WIT)
- Sales Tax
- Individual Income Tax returns (IIT) for owners, partners, etc. of the entity being audited
- Any other miscellaneous taxes for which the taxpayer is liable

NOTE: WHEN LOOKING AT INDIVIDUAL INCOME TAX RETURNS IN GENTAX, THE AUDITOR MUST ENTER A CRM STATING THE REASON FOR THE INQUIRY.

There is no requirement for auditors to break out and separately account for audit hours spent on withholding or income tax compliance checks done in conjunction with ROT audit assignments. All hours devoted to reviewing these areas will be included in the hours charged to the primary assignment unless a liability is uncovered.

The auditor must make sure that the date of the compliance check is documented on the EDC-5 and the EDA-8, Audit Questionnaire. You should also document that you checked compliance in your audit narrative. This should include an explanation of what you checked, what you found, and the actions you took, if any, to bring the taxpayer into compliance. In STT the EDA-8, Audit Questionnaire, can be found in the STT Processing folder. The resulting two page report will be included in the audit package along with the EDC-5 and audit narrative.

1. TAX TYPES

The Auditor must determine all of the tax types for which the entity is registered and the filing status of each type prior to the opening conference or very early in the audit. The filing status for both business entities and individuals must be verified for the same period as the audit. The Department's uniform compliance approach requires that Audit Bureau personnel also verify individual income tax filing of all partners, shareholders, officers and sole proprietors during the course of routine audits of businesses.

The Account column at the Customer Manager, lists all of the tax types for which the taxpayer is required to file returns. The objective of compliance checks is to verify that all returns have been filed. Reviewing the list of

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returns in each Account Manager will show this. Within GENTAX, all of the taxpayer's accounts that have been converted into GENTAX can be found on the Customer Manager. The following table is an example of information that might be provided in the accounts panel:

ID	TYPE	Filing	BALANCE
05XXX-88XXX	Business	Annual	
55XX-55XX	ST-1	Monthly	(3,319.49)
20-XXXXXXX-000	Withholding	Quarterly	(4.08)
55XX-55XX	ST-14	Monthly	
55XX-55XX	ST-8	Monthly	
55XX-55XX	ST-4	Monthly	
55XX-55XX	PST-1	Monthly	

- Within GENTAX, access the accounts from the Customer Manager
- Click on the account ID which will bring up the Account Manager for that tax type.
- Click on the returns tab to bring up the listing of returns by period.

- Click on the Export icon to export the listing to a Word or Excel file, rename and save the document. The exported file will look similar to the example below.

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[redacted]

- Repeat these steps on the remaining account IDs
- When all accounts have been exported, all of the exported files can either be combined into one report or kept separately. Each report must have the taxpayer's identifying information entered on it. An example of a one page combined Compliance Report is shown below:

Qualified Innovation
0000-0000
A999996768

[redacted]

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This compliance report can now be used to see if there are open (un-filed) periods. Each return will have a "status" which indicates if it has been filed on time, filed late, not filed or suspended due to some error. If the status shows "Late-Prcd" in the Sales Tax returns account, the auditor must look to see if there was a late filing penalty assessed on the original Sales Tax return. If there was a late filing penalty imposed, then the late filing penalty also has to be assessed on any additional liability for that period.

The auditor can use this report to identify open periods. However, any screen prints or other exported pertinent taxpayer information cannot be included in the CAF. The auditor must document in the EDC-5, EDA-8 and auditor narrative that the compliance check was completed on all tax types that the taxpayer is responsible for.

All Auditors are required to complete compliance checks as a part of their audits with the exception of unitary audits. As a result, other related non-filers may be uncovered from the following types of taxpayers earning income in Illinois:

- Sole Proprietorships;
- Shareholders of an S-Corporation;
- Partners of a Partnership;
- Beneficiaries of Estates or Trusts.

The Auditor should determine if the sole proprietor, shareholders, partners, or beneficiaries have filed individual income tax returns. Individual Income Tax (IIT) records may be checked through GenTax. Partners and shareholders could be included in a Composite return (IL-1023-C).

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Individual income tax – IL-1040

Most of the non-filers uncovered will be individuals who are required to file IL-1040s. If the individuals have not filed at the time of the audit closing, it will be necessary to advise them on an individual basis and close the open periods, bringing the taxpayer into compliance by picking up any delinquent returns. When necessary, the IRS should also be notified through our Disclosure Officer.

We will continue to pursue non-filers if the liability due is in excess of [redacted] in tax, penalty and interest for the audit period. Department policy is to "look back" six years on non-filers to check for any filing history in those years.

Abusive Tax Avoidance Transactions (ATAT)

There is a six-year NOD statute on these types of transactions provided for through PA 93-0840. This gives the Department a six-year statute from the extended due date of the return or the date the return was filed; whichever is later, in order to assess tax from an undisclosed reportable transaction.

The compliance check for individual income tax returns within GENTAX is basically the same as for BIT, WIT and Sales tax compliance checks.

- Bring up the Search Manager and enter the name (last name, first name) or SSN of the individual.
- Click on the taxpayer's name to access the Customer Manager.
- Click on the account ID to open the Financial Springboard in the Account Manager.
- Click on the Returns tab to bring up the Return-by-Period panel and then click the Export icon to export the listing to a Word or Excel file, rename and save the document. The exported file will look similar to the example below.

[redacted]

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- Repeat these steps on the remaining names and ID numbers

When all individual return information has been exported, all of the exported files can either be combined into one report or kept separately. **These files cannot be included in the CAF.**

B. PROEDURES FOR DETERMINING FILING STATUS

The filing status for both business entities and individuals should be verified for same period as the audit.

Business Entities

1) Owners, Shareholders, Partners or Beneficiaries

The Auditor must determine the identity of the owners, shareholders, partners or beneficiaries before verifying compliance. In order to do so, copies of the following documents, which contain the identity of owners, etc. may need to be obtained for each type of entity:

- S Corporation - IL-1120-ST and Schedules B and C or U.S. 1120S and Schedules K-1 for each shareholder - The schedules contain the names, addresses and SSNs or FEINS of the shareholders and each shareholder's income information.

- Partnership - U.S. 1065 and Schedule K-1 for each partner - The schedules K-1 identifies each partner and details each partner's distributive share of income, deductions, credits, etc.

- Trusts or estates - IL-1041 and Schedules D and E or U. S. 1041 and Schedules K-1. - These schedules identify the beneficiaries and detail each beneficiary's trust/estate income.

Composite Returns (IL-1023-C) and Pass-Through Withholding (IL-1000)

For tax years ending on or after December 31, 2014, both Form IL-1023-C and Form IL-1000 have been eliminated.

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Starting as of that date, this required information will be included on the respective income tax forms (IL-1120-ST, IL-1065, or IL-1041 – Schedule B or Schedule D).

Beginning with taxable years ending December 31, 2008, S-Corporations and Partnerships were required to withhold tax from business income passed through to all nonresidents that are not included on a composite return and do not meet the criteria of specific exceptions. S Corporations and partnerships report the income passed through to each owner and the amount of tax paid on the owner's behalf on a composite return (IL-1023-C) or as pass-through withholding (IL-1000).

The Auditor can review Composite, S Corporation and partnership return information in GenTax (or Legacy PDF Display). However, the identity of the partners or shareholders included must be obtained from the actual list, which is attached to the IL-1023-C, the IL-1120-ST or the IL-1065.

- If the Auditor determines that all of the income, modifications, etc. reported on the S Corporation or Partnership return (IL-1120-ST or IL-1065) is included on the composite return, no further action is needed to verify the filing status of the partners and shareholders.

- If review of the composite, S Corporation and partnership return information reveals that all of the income, etc. is not reported, then the Auditor must obtain the list of partners and shareholders included on the composite return and compare it to the list reported as partners and shareholders on the IL-1120-ST or IL-1065. The filing status of the partners and shareholders not included on the composite return should be verified. If no returns were filed, then the Auditor must bring those non-filers into compliance.

2) Closely Held Corporations

For closely held corporations, IL-1040 filing will need to be verified when five or fewer individuals own at least 50% of the corporation's stock. If they are all Illinois residents, returns must be secured regardless of the level of tax. An owner who resides out-of-state may not be required to file an individual

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income tax return (IL-1040).

Individuals

To estimate the individual income tax liability due per year, the sum of income plus additions minus subtractions should be multiplied by the apportionment factor, if applicable. The result should be reduced by one exemption and multiplied by the applicable tax rate. We use one exemption because we have no way of knowing the taxpayer's allowable exemptions.

Out-of-State Sole Proprietors

For out-of-state sole proprietors who have not filed individually (i.e.-construction contractor), the field auditor should refer to his/her supervisor, on a case by case basis, to determine whether the sole proprietor has frequented the state enough to subject him/her to Illinois income tax.

- Sole Proprietorship - U.S 1040, Schedule C - The income and expenses from the business will be listed on the Schedule C.

1. Procedures for Closing Open Periods – IIT/BIT

Due to confidentiality reasons, the non-filing partner, shareholder, etc. should be contacted individually to secure original returns. A time frame should be established for the taxpayer to comply.

- If the taxpayer does not comply, the estimated liability should be determined and if over tolerance, the Auditor should either establish the liability or submit an audit referral on the non-filer to Audit Planning.

- If the taxpayer representative comes forth and wants to close the non-filing partners and shareholders open periods with composite returns and they are eligible to do so, the Auditor can accept the original composite return or establish the liability through audit procedures.

- If the taxpayer submits original returns, the Auditor should perform a cursory review of those returns. At a minimum, the Auditor should make sure the returns contain a name, address, Social Security

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number and signature.

- If the return is not signed, the Auditor needs to request the taxpayer sign the return, either while at the taxpayer's location or via correspondence providing an IDR-916, Signature Declaration.

  1) If the taxpayer provides the requested signature within 30 days of notification, the Auditor should close the track as paid (if payment was provided) and follow the procedures as outlined later in this chapter.
  2) If the taxpayer does not provide the requested signature within 30 days of notification, the audit will be close as "AL" and considered to be deemed assessed per IITA § 503(e).

- If a payment is attached, the Auditor should close the track as paid and follow the procedures as outlined later in this chapter.

- If the returns are not fully paid, the Auditor should inform the taxpayer that they will be receiving a bill from the Department once the returns are processed.

For any identified non-filer, the auditor should:

- Complete form SC-137, Audit Referral/Request, and submit (along with required attachments) to their supervisor for approval and the supervisor's signature.

- Once approved, the referral will then be sent to Audit Planning in Springfield [email to REV.G.ITAuditPlanning@illinois.gov] who will set up the audit track and email the track information back to the auditor and supervisor.

- A regular individual Income Tax audit should be conducted for the non-filing taxpayer. The audit assignment should be completed following normal audit procedures.

C. WITHHOLDING TAX ADDITIONAL COMPLIANCE CHECKS

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All Income Tax and Sales Tax auditors are required to complete the following withholding tax compliance check. This compliance check is required on non-unitary and unitary taxpayers for income tax purposes.

In cases when the taxpayer is unitary, the focus will be on the nexus filers. For sales tax purposes, the focus is on whomever is paying the Illinois withholding tax for the taxpayer. If the taxpayer is not in compliance for withholding, ALL auditors will be required to complete the related withholding tax audit(s). If it is determined that a withholding tax audit will have to be completed, the auditor will have to request that Audit Planning set up the withholding audit so that it can be completed.

When completing the withholding tax compliance check, there are five required research items that must be identified in the audit comments for the Income Tax or Sales Tax audit. Additionally, it must be noted on the EDC-5 whether or not a withholding audit was necessary as a result of the research conducted.

The **six** required components are:

1) Commence date

2) Cease date

3) Filing compliance

a) Non-filer –
   i) Non-Filers are taxpayers that have never filed withholding tax returns or those that filed and then discontinued filing without ceasing the withholding tax account

b) Skip-filer –
   i) Skip-filers do not consistently file their withholding tax returns.

4) Payment compliance – for periods prior to January 1, 2017

a) Annual
   i) This payment schedule is for taxpayers with a withholding tax liability of $1,000 or less – payments are due annually. The annual payment is due by January 31st of the following year for amounts withheld the entire preceding year.

b) Monthly
   i) This payment schedule is for taxpayers with a withholding tax

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liability of more than $1,000, but no more than $12,000 – payments are due monthly. The monthly payments are due by the 15th of each month for amounts withheld the preceding month. Taxpayers on a monthly pay schedule file quarterly returns.

c) Semi-weekly

i) This payment schedule is for taxpayers with a withholding tax liability of over $12,000 – payments are due electronically on a semi-weekly basis. The payments are due by Wednesday for amounts withheld on the preceding Wednesday, Thursday, or Friday and Friday for amounts withheld on the preceding Saturday, Sunday, Monday or Tuesday. Taxpayers on a semi-weekly payment schedule file quarterly returns.

ii) For semi-weekly payers the focus from auditor's standpoint is on the taxpayer being predominantly in compliance. Taxpayers that are predominantly in compliance have made more than six IL-501 payments (identified on GENTAX as Pym-Estimated) per quarter.

5) Inquiry on Federal withholding tax audit

a) The auditor needs to inquire on whether the taxpayer has had a federal withholding tax audit. If no, then this portion of the compliance check is complete. If yes, the taxpayer will need to identify the periods that were audited and provide the applicable federal audit documents. The auditor will then need to review the federal information provided to determine if the federal audit changes affect the withholding taxes paid to Illinois

6) Employee classification compliance (if warranted).

NOTE: Effective January 1, 2017, **all** taxpayers are required to file their IL-941 returns quarterly and pay their liabilities either monthly (less than $12,000/ quarter) or semi-weekly (liability more than $12,000/ quarter). For additional information, see Informational Bulletin FY 2017-07.

D. REQUIRED RESEARCH

1. COMMENCE AND CEASE DATES

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These are the start and end dates for the withholding tax account. The commence date and cease date can be found in GenTax on the same screen in the Withholding Account View. Click on the Withholding Account number.

The Withholding Account Information (View) screen opens as shown below. The commence date is the starting date for withholding, while the cease date is the end date for the withholding tax account. For active accounts there should be no information provided for the cease date. If a cease date is provided then no withholding tax returns would be expected for dates falling after the cease date.

This taxpayer shows a Commence date of August 1, 1969, and is currently active with no Cease date.

2. FILING COMPLIANCE

To verify filing compliance, an analysis of the taxpayer's filing history must be done. The withholding commence and cease dates establish a time frame for which the auditor should expect to see withholding tax returns filed.

The filing frequency for each withholding tax account should either be quarterly (4 quarters per year) or annually (1 year end return). These are the only two filing options.

Quarterly Filers – Withholding tax returns are due by the last day of April for January through March, the last day of July for April through June, the last day of October for July

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through September and the last day of January for October through December.

Annual Filers – Withholding tax returns are due by January 31st of the following year for amounts withheld the entire preceding year. Effective January 1, 2017, all Illinois Withholding Income Tax filers will be required to file their IL-941 returns quarterly. The annual filing option will no longer be available.

Note: If a taxpayer is designated as an Annual Filer but begins filing Quarterly returns, the taxpayer may become subject to penalty and collection action. Once a Quarterly return is received, the taxpayer has changed his filing frequency to quarterly and is thus subject to the quarterly filing requirements for return and monthly payment due dates.

The current filing frequency assigned to the taxpayer should be noted in the audit comments. Each year must be checked and verified as to the frequency for that particular year, and also included in the comments. Current filing frequency can be seen on the Withholding Account Information screen. To access additional filing information, click on the Registration Tab.

The Account sub-tab within the Registration Tab provides the following information:

- Tax filing frequency (Quarterly shown below)
- Date of the last time that a change was made (see batch date)
- Number of changes that have been made to the withholding attributes for this account (11 of 11 below). Arrows can be used to scroll through the changes.

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The filing compliance check should go back six years, and all six years must be checked independently since filing status could change in a given year.

Filing History in GenTax:
Filing history is found in the Returns sub-tab under the Financial Tab.

To export the full filing history that is available in GenTax, click on the Menu tab.

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[redacted]

3. ANALYZING FILING HISTORY

- If All Withholding Tax Returns Have Been Filed:

  A quarterly filer should have 24 returns filed (four per year). An annual filer should have 6 returns filed (one per year).
  If the taxpayer has filed all of their withholding tax returns, then the audit comments need to reflect this and the filing portion of the compliance research is complete. (Note: Late returns are assessed penalty in GenTax and are not a focus of the filing compliance check.)

- If Any Withholding Tax Return Is Missing:

  If the taxpayer is missing any withholding tax return in the filing history, the auditor will need to request additional information from the taxpayer for the missing period(s).

  a) What to ask for:
     - Ask for a completed, signed return for the missing period(s).

  b) If the taxpayer does not or cannot supply the return then:

     - Ask for Form W-2s issued for the period(s) that have the missing return(s). (Note that W-2s are issued by the taxpayer to employees annually.)

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If the taxpayer does have W-2s for the period(s) with missing return(s) then the auditor will have to request a withholding audit for this taxpayer.

- Request a Non-filer Audit –
  Non-Filers are taxpayers that have never filed withholding tax returns or those that filed and then discontinued filing without ceasing the withholding tax account.

- Request a Skip Filer Audit –
  Skip filers do not consistently file their withholding tax returns. When this audit is requested the reason for referral on the SC-137 must specifically state the periods needed for the audit.

- If the taxpayer does not have W-2s then:

  - Ask for copies of their federal Forms 941, copies of their IDES (Illinois Department of Employment Security) Reports (if applicable), and copies of their in-house payroll reports (i.e. payroll ledger or report of Illinois tax withheld from payroll checks by pay period with both quarterly and annual totals).

    If the taxpayer has this information then the auditor will have to request a withholding audit for this taxpayer.

    Request a Non-filer Audit or a Skip Filer Audit
    (As per previously defined, the auditor must select the appropriate audit type for the current situation.)

    If the taxpayer does not have the federal Forms 941, IDES reports or in-house payroll reports then:

  - Ask for Form 1099s that have been issued. 1099s are forms used for taxpayers to report non-employee compensation for independent contractors, consultants, investors, etc.

    If the taxpayer has issued 1099s and can provide these forms for the periods in question then the filing portion of the compliance check is complete.

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The audit comments need to clearly state a cease date for the withholding account, as taxpayers who only issue Form 1099s are not required to pay withholding taxes. A processing note is required to notify Audit Perfection that a withholding tax cease date must be added in GenTax at the time the Income Tax or Sales Tax audit is processed. The cease date identifies the last date of the tax period for which the taxpayer was required to file. The cease date provides information that will assist other users in future contact with the taxpayer's account.

- If there are multiple, consecutive returns missing in the filing history:

  - Ask the taxpayer if they outsource their employment tax function.

    If the answer is yes then the taxpayer needs to provide the name and FEIN of the PEO (Professional Employer Organization) that handles the taxpayer's withholding taxes. The taxpayer should also provide a copy of the PEO contract. This contract will show the start date for which the PEO will be responsible for the withholding taxes. In cases when taxpayers have proof of a PEO for withholding tax periods that are missing, this will conclude the filing compliance check.

    If the taxpayer cannot provide any of the additional information requested based on the filing compliance check, then refer to the immediate supervisor for guidance in this situation.

NOTE: Remember when dealing with a unitary business group, the taxpayers with the **ten** highest annual Illinois withholding liabilities should be checked for compliance, if more than one entity is paying Withholding tax.

a) FILING AND PAYMENT FREQUENCY

Effective January 1, 2017, all Illinois Withholding Income Tax filers will be required to file their IL-941 returns quarterly. The annual filing option will no longer be available. Also effective January 1, 2017, all Illinois Withholding Income Tax filers will be assigned to pay withholding income tax on a monthly or semi-weekly schedule. The annual payment option will no longer be available.

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Beginning January 1, 2012, the Department added a new payment/return schedule, bringing the total to four. These four payment/return schedules are:

- Semi-weekly Payment/ Quarterly Return - Taxpayers are assigned this schedule when they have reported more than $12,000 during the "look-back" period. Beginning 1/1/2011, employers who are required to make semi-weekly payments must make all payments electronically.

- Monthly Payment/ Quarterly Return - Taxpayers who have been registered less than 18 months, or have a compliance problem (underpayment, missing returns, etc.), and reported $12,000 or less during the "look-back" period are assigned this schedule. New taxpayers are automatically assigned to the monthly payment/ quarterly return due date schedule.

- Monthly Payment/ Annual Return - Taxpayers who have been registered for the full "look-back" period, are in good standing, and reported more than $1,000 but no more than $12,000 in withholding, are assigned this schedule. Effective January 1, 2017, annual filing will no longer be an option.

- Annual Payment/ Annual Return - Taxpayers are assigned this schedule when they have reported $1,000 or less during the "look-back" period and are in good standing with the Department. Effective January 1, 2017, annual payment and annual filing will no longer be options.

Payment and filing requirements are determined by the total tax withheld during the "look-back" period, which is the one-year period ending on June 30 of the immediately preceding calendar year. (For example, for calendar year 2012, the look-back period is July 1, 2010, through June 30, 2011.) Note: The reason that the Department utilizes this period time-span for "look-back" is that letters are generated in October of every year indicating the changes in payment/filing requirements for taxpayers in the upcoming year.

For additional information on payment/ return schedules, see Publication 131, Withholding Income Tax Payment and Filing Requirements, on the IDOR website at www.tax.illinois.gov under Publications.

4. PAYMENT COMPLIANCE

The withholding tax payment frequency must be verified to ensure that taxpayers are making the required payments timely. For payments not submitted timely, it is important to note that penalties and interest can only be assessed on the last three years, as previous years would be out of statute.

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NOTE: When reviewing payment history for timeliness, a *Trans Type* of "Adj – Unverified WIT Credit" could be indicated as shown below. If this payment type shows on the account, do not include that amount in the compliance check.

Taxpayers are assigned a payment schedule for each tax year and must be in compliance with that schedule. The assigned payment schedule (annual, monthly or semi-weekly) is determined by the amount of tax withheld during a "look-back" period, which is the one-year period ending on June 30 of the immediately preceding calendar year. (For 2014, the look-back period is July 1, 2012 through June 30, 2013).

The payment frequency assigned to the taxpayer is found in the Account sub-tab under the Registration Tab in the Withholding Account View (same screen as for filing frequency above).

It is important to realize that a taxpayer's payment frequency may change during the year. If the tax liability exceeds $12,000 in any particular quarter, the taxpayer would be required to switch to the semi-weekly payment schedule and continue

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for both the remainder of the current year and for the following year. Analysis of both the total tax liability for the year and the total tax liability for each quarter must be made during the payment compliance check.

NOTE: For any payment information that needs exported, use the Menu tab to access "Export". See additional instructions in the Filing Compliance section above.

[redacted]

a) ANNUAL PAYMENT SCHEDULE

For taxpayers with a withholding tax liability of $1,000 or less – payments are due annually by January 31st of the following year for amounts withheld the entire preceding year.

Example – Taxpayer is assigned to the annual payment schedule and is in compliance.

Verify 2010 for the following taxpayer on an annual payment schedule. The taxpayer attributes indicate that at the time of the 2010 filing this taxpayer was assigned the annual payment and return schedule.

[redacted]

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The Transactions sub-tab below shows both the annual payment made and the annual return filed for the 2010 period.

The first step is to add up the tax liability for the year to verify that the correct payment schedule is being used.

The total tax liability for the year is $985.00 which is less than $1,000. The taxpayer should be using the annual payment and return schedule.

The second step is to verify that the taxpayer paid the tax due timely.

A payment in the amount of $985.00 was made on January 9, 2011 for this period, which is timely for an annual filer.

This taxpayer is in compliance for 2010.

Once all applicable tax periods are verified and found in compliance, then the payment compliance check is complete.

b) MONTHLY PAYMENT SCHEDULE

For taxpayers with a withholding tax liability during the look-back period of more than $1,000, but no more than $12,000 – payments are due monthly. The monthly payments are due by the 15th of each month for amounts withheld the preceding month.

Example 1 – Taxpayer is assigned to the monthly payment schedule and is in compliance.

Verify 2010 for the following taxpayer on a monthly payment schedule. The taxpayer attributes indicate that at the time of the 2010 filing this taxpayer was assigned the monthly payment and the quarterly return schedule.

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[redacted]

The monthly payments can be confirmed in the Payments sub-tab under the Financial Tab. All twelve payments show as timely, as indicated under the effective dates. The auditor needs to verify that all payments were made timely.

[redacted]

The payments will need to be compared to the Quarterly returns filed as shown in the Periods sub-tab under the Financial Tab below.

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[redacted]

Using the Periods sub-tab above, add up the tax liability for 2010.
1st quarter 2010 $3,000
2nd quarter 2010 $2,500
3rd quarter 2010 $1,263
4th quarter 2010 $1356.90
Total 2010 tax liability is $8,119.90.

With a total tax liability for the year at $8,119.90 the taxpayer was not required to switch to the semi-weekly payment schedule during the year.

> NOTE: If at any time during the tax year the tax liability for a particular quarter exceeds $12,000, the taxpayer would be required to switch to the semi-weekly payment schedule and continue the semi-weekly payment schedule for the remainder of the current year and for the following year.

The auditor will need to review the payments made for the 2010 tax year to verify that these payments were made timely (see above Payments sub-tab). Payments are due by the 15th of each month for the amounts withheld on the preceding month.

The taxpayer has made each monthly payment timely and is in payment compliance for 2010. Once all applicable tax periods are verified and found in compliance, then the payment compliance check is complete.

Example 2 – Taxpayer is assigned to the monthly payment schedule and **not** in compliance.

Verify 2009 for the following taxpayer on a monthly payment schedule. The taxpayer attributes indicate that at the time of the 2009 filing this taxpayer was assigned the monthly payment and the quarterly return schedule.

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The Payments sub-tab shows only one payment (return payment) for 2009.

The Periods sub-tab below shows activity in one quarter (period) only.

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Using the Periods Panel, add up the tax liability for 2009.-
1st quarter 2009 $0
2nd quarter 2009 $0
3rd quarter 2009 $440.05
4th quarter 2009 $0
Total 2009 tax liability of $440.05

With a total tax liability for the year at $440.05, the taxpayer was not required to switch to the semi-weekly payment schedule during the year.

> NOTE: If at any time during the year the tax liability for a particular quarter exceeds $12,000, the taxpayer would be required to switch to the semi-weekly payment schedule and continue the semi-weekly payment schedule for the remainder of the current tax year and for the full year following this year.

The auditor will need to review the payments made for 2009 to verify that the payments were made timely. Payments are due by the 15th of each month for the amounts withheld during the preceding month.

Obviously, this taxpayer did not make each monthly payment that is required for 2009, as only one payment was made and it was made after the last possible due date for payment for the quarter for which it was reported. This taxpayer is not in compliance for 2009.

Example 3 – Note: For this example only, screen prints from GenTax Version **8** will be used, as this WIT history presents an excellent example.

Taxpayer is assigned to the monthly payment schedule and in a single quarter the tax liability exceeds $12,000 in withholding. Once this happens in a single quarter, the taxpayer is required to switch to the semi-weekly payment schedule effective immediately for the remainder of the current year and for the Subsequent year.

Verify 2009 for the following taxpayer on a monthly payment schedule.

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Withholding Tax Account Manager, Periods Panel

[redacted]

In the Periods Panel it can be seen that the monthly payment schedule would be correct until the taxpayer files the second quarter return for 2009. At the time the second quarter return is filed the taxpayer exceeds the $12,000 liability amount for one quarter and is then required to follow the semi-weekly payment schedule for the third and fourth quarters of 2009. (See the semi-weekly payment schedule section for applicable rules)

Next, the auditor will need to view the payments for compliance.

Exported Payment Information

26-Jan-2010	15-Jan-2010	31-Dec-2009	Pym - Return	716.77	3rd and 4th q
26-Jan-2010	11-Dec-2009	31-Dec-2009	Pym - Estimated	400.00	
26-Jan-2010	11-Nov-2009	31-Dec-2009	Pym - Estimated	400.00	
26-Jan-2010	10-Oct-2009	31-Dec-2009	Pym - Estimated	450.00	
02-Nov-2009	06-Sep-2009	30-Sep-2009	Pym - Estimated	400.00	
02-Nov-2009	09-Aug-2009	30-Sep-2009	Pym - Estimated	400.00	
02-Nov-2009	11-Jul-2009	30-Sep-2009	Pym - Estimated	400.00	2nd q
22-Jul-2009	10-Jul-2009	30-Jun-2009	Pym - Return	30.25	
22-Jul-2009	25-Jun-2009	30-Jun-2009	Pym - Estimated	12,600.00	
22-Jul-2009	28-May-2009	30-Jun-2009	Pym - Estimated	400.00	
22-Jul-2009	27-May-2009	30-Jun-2009	Pym - Estimated	1,500.00	
22-Jul-2009	14-May-2009	30-Jun-2009	Pym - Estimated	400.00	
24-Apr-2009	05-Apr-2009	31-Mar-2009	Pym - Estimated	450.00	1st q
24-Apr-2009	12-Apr-2009	31-Mar-2009	Pym - Return	958.44	
24-Apr-2009	13-Mar-2009	31-Mar-2009	Pym - Estimated	1,500.00	

Payments are due by the 15th of each month for the amounts withheld during the preceding month.

The taxpayer does not appear to be in compliance as they have not timely made each monthly payment that is required for the first and second quarters of 2009 and additionally they have not made the semi-weekly payments that would be required for the third and fourth quarters of 2009.

The auditor will have to request the taxpayer's in-house payroll reports (i.e. payroll ledger or report of Illinois tax withheld from payroll checks by pay period with both quarterly and annual totals). Upon review of the records and all other applicable periods, the auditor may have to complete SC-137 to request a monthly payment frequency withholding tax audit to complete.

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c) SEMI-WEEKLY PAYMENT SCHEDULE

For taxpayers with a withholding tax liability during the look-back period of over $12,000 – payments are due semi-weekly. Taxpayers on a semi-weekly payment schedule file quarterly returns.

If the paychecks are issued on a Wednesday, Thursday or Friday, the withholding payment is due by the following Wednesday. If the paychecks are issued on a Saturday, Sunday, Monday or Tuesday, the payment is due by the Friday following.

For semi-weekly payers the focus from the auditor's standpoint is on the taxpayer being **predominantly in compliance (PIC)**. If at least six payments show per quarter (based on the assumption that employees are paid twice monthly at a minimum), the taxpayer is PIC. Payments are identified on GenTax as "Pym-Estimated", as viewed in the financial data under the Transaction sub-tab.

►**Do not** proceed further for any tax years that have the following indicator on the Withholding Account in the Indicators sub-tab under the CRM Tab:

When the mouse is hovered over "WIT S/W Pmt Inq", it will identify the period that is included in the Discovery project for semi-weekly payors that are not in compliance.

Example above - the message reads, period from "31-Mar-2011 to 31-Dec-2011 Semi-Weekly Pym Inquiry WIT Discovery". Periods included in the discovery period must be noted in the audit comments and then the auditor can proceed with the other tax years in question.

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If for a particular quarter the taxpayer is PIC, then the payment compliance check is complete for that quarter. If the taxpayer is not PIC, then the auditor will have to further analyze the account and potentially request an audit. This would be a payment frequency (penalty and interest only) audit.

Example 1 – Taxpayer is assigned to the semi-weekly payment schedule and is in compliance.

Verify 2011 for a taxpayer on a semi-weekly payment schedule. The taxpayer attributes indicate that at the time of the 2011 filing this taxpayer was assigned the semi-weekly payment and the quarterly return schedule.

[redacted]

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The Periods sub-tab below shows the activity for all four quarters.

[redacted]

Add up the tax liability for 2011.

1st quarter 2011 $392,373.10
2nd quarter 2011 $338,197.45
3rd quarter 2011 $340,773.08
4th quarter 2011 $314,327.41
Total 2011 tax liability is $1,385,671.04

With a total tax liability for the tax year at $1,385,617.04 the taxpayer should be using the semi-weekly payment and quarterly return schedule.

Next, start with the first quarter of 2011 and click on 31-Mar-2011 to view the transactions for this period to verify that the payments made put the taxpayer predominantly in compliance.

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Transactions sub-tab for 31-Mar-2011

[redacted]

This taxpayer is PIC for the first quarter of 2011 as they have made twelve withholding tax payments for this quarter. Each quarter of 2011 will have to be verified for the auditor to know that the tax year is PIC.

Transactions sub-tab for 30-Jun-2011

[redacted]

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Transactions sub-tab for 30-Sep-2011

[redacted]

Transactions sub-tab for 31-Dec-2011

[redacted]

This taxpayer is PIC for all of 2011 since more than six payments were made per quarter.

Once all applicable tax periods are verified and found in compliance, then the payment compliance check is complete.

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Example 2 – Taxpayer is assigned to the semi-weekly payment schedule and is **not** in compliance.

Verify 2012 for the taxpayer on a semi-weekly payment schedule. The taxpayer attributes indicate that at the time of the 2012 filing this taxpayer was assigned the semi-weekly payment and the quarterly return schedule.

[redacted]

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The Periods sub-tab below shows the activity for all four quarters.

[redacted]

Add up the tax liability for 2012.
1st quarter 2012 $20,884.73
2nd quarter 2012 $20,988.16
3rd quarter 2012 $24,033.44
4th quarter 2012 $25,623.59
Total 2012 tax liability is $91,529.92

With a total tax liability for the tax year at $91,529.92 the taxpayer should be using the semi-weekly payment and quarterly return schedule.

Next, start with the first quarter of 2012 and click on 31-Mar-2012 to view the transactions for this period. Here it can be verified if the payments made put the taxpayer PIC.

Transactions sub-tab for 31-Mar-2012

[redacted]

This taxpayer is not PIC for the first quarter of 2012 as they have only made three withholding tax payments for this quarter. To be PIC the taxpayer would have had at least six payments for the quarter. It appears that the taxpayer is paying as if they are on a monthly payment schedule.

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Transactions sub-tab for 30-Jun-2012

Transactions sub-tab for 30-Sep-2012

Transactions sub-tab for 31-Dec-2012

This taxpayer is not PIC for any quarter of 2012.

The auditor will have to request the taxpayer's in-house payroll reports (i.e. payroll ledger or report of Illinois tax withheld from payroll checks by pay period with both quarterly and annual totals). Upon review of the records and all other applicable periods, the auditor may have to complete SC-137 to request a semi-weekly payment frequency withholding tax audit to complete.

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Example 3 – Taxpayer is assigned to the semi-weekly payment schedule, is only making their withholding tax payments monthly, but is in compliance per the payroll records requested, which indicates that the taxpayer pays payroll once per month. Figures used in Example 2 above are being used for this example also.

Verify 2012 for a taxpayer on a semi-weekly payment schedule. The taxpayer attributes indicate that at the time of the 2012 filing this taxpayer was assigned the semi-weekly payment and the quarterly return schedule.

The Periods sub-tab below shows the activity for all four quarters. With a total tax liability for the tax year at $91,529.92 (all four quarters totaled), the taxpayer should be using the semi-weekly payment and quarterly return schedule.

Transactions sub-tab for 31-Mar-2012

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Transactions sub-tab for 30-Jun-2012

Transactions sub-tab for 30-Sep-2012

Transactions sub-tab for 31-Dec-2012

This taxpayer is not PIC for any of the quarters of 2012 as they have only made three withholding tax payments for each quarter.

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The auditor will have to request the taxpayer's in-house payroll reports (i.e. payroll ledger or report of Illinois tax withheld from payroll checks by pay period with both quarterly and annual totals).

However, in this case after reviewing the payroll records the auditor can see that the taxpayer does pay its payroll one time each month. Additionally, the auditor can see that the taxpayer pays its withholding tax due from its payroll timely, based on the requirements for the semi-weekly payment schedule. Therefore, the taxpayer is in compliance with the semi-weekly payment schedule.

It is important to note that not all taxpayers assigned to the semi-weekly payment schedule are required to have six or more withholding tax payments. The payroll frequency determines the total amount of payments that are needed for the taxpayer to be in compliance.

5. RAR COMPLIANCE – FEDERAL WITHHOLDING TAX AUDIT

The auditor needs to inquire whether the taxpayer has had a federal withholding tax audit. If no, then this portion of the compliance check is complete. If yes, the taxpayer will need to identify the periods that were audited and provide the applicable federal audit documents. The auditor will then need to review the federal information provided to determine if the federal audit changes affect the withholding taxes paid to Illinois. The changes made may affect employees that are nonresidents of Illinois and therefore may not impact Illinois withholding tax.

If the changes do affect Illinois, the auditor will need to determine whether the changes have been properly reported to Illinois. If the changes have been properly reported to Illinois then this portion of the compliance check is complete. Properly reported means IL-941-X returns were filed reporting the Illinois portion of the federal change.

If the changes have not been reported to Illinois, the auditor will need to obtain copies of all federal audit documentation and submit them with the SC-137 (see Section V) for a withholding tax audit to be done in-house.

A reminder that the federal return may be different than the Illinois return (especially with National or International companies) so depending on the federal RAR changes the federal changes may affect Illinois items differently.

Underreporting (Omission)

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For any period beginning on or after January 1, 2013, if the taxpayer omits more than 25% of the total amount of withholding required to be reported on that return under IITA § 704A, a Notice of Deficiency (NOD) may be issued no later than 6 years after the return was filed. Ref: IITA § 905(b)(3).

6. EMPLOYEE CLASSIFICATION COMPLIANCE

This type of compliance is only necessary when an auditor is questioning a worker's status as an independent contractor verses an employee of a company.

The Internal Revenue Service (IRS) has established guidelines to aid in determining whether a worker is an independent contractor or an employee. This determination is important when an audit requires proof of withholding compliance.

IRS basic definition of employee:

> An individual who performs services for you who is subject to your control regarding what will be done and how it will be done. (Treas. Reg 31.3121(d)-1(c)(1))

On the state level, this same issue of whether a worker is an independent contractor or an employee may surface during a withholding compliance check in an audit. It is important to realize that if federal withholding tax (FWT) is required, then state withholding tax (SWT) will be required for wages paid in this State (Illinois) in **most** cases.

For exceptions to withholding, see Publication 130, Who is Required to Withhold Illinois Income Tax, which can be accessed on the IDOR website at www.tax.illinois.gov under Publications.

The following information may be utilized to help in determining a worker's status.

a) Independent Contractor or Employee Determination

- The Common Law Standard

In determining a worker's status, the primary inquiry is whether the worker is an independent contractor or an employee under the common law standard.

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The common law flows mainly from court decisions within the justice system in the United States. Under the common law, the treatment of a worker as an independent contractor or an employee originates from the legal definitions developed in the law of agency – whether one party (the principal) is legally responsible for the acts or omissions of another party (the agent) – and depends on the principal's right to direct and control the agent.

Gaining an understanding of the way a business operates, and the relationship between that business and the worker, can aid in determining the worker's status.

- Twenty Common Law Factors

Every piece of information that helps determine the extent to which the business retains the right to control the worker is important. There are twenty common law factors that help with the business/worker determination. The importance and weight of these twenty can vary significantly.

1) Instructions
2) Training
3) Integration
4) Service rendered personally
5) Hiring, supervising, and paying assistants
6) Continuing relationship
7) Set hours of work
8) Full-time work required
9) Doing work on business owner's premises
10) Accomplishing work in certain order or sequence
11) Submission of oral or written reports
12) Method of payment
13) Payment of business or traveling expenses
14) Furnishing tools and equipment
15) Significant investment
16) Realization of profit or loss
17) Work for one entity at a time
18) Offer their services to the general public
19) Right to discharge
20) Right to terminate

The above factors can be useful in the worker determination. However, other relevant information may be utilized in determining if an employer-employee relationship exists. The following areas should be considered:

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- What the business does and how the job gets done.
- The relationship between the business and its clients or customers.
- Facts that indicate whether the business has the right to control how the work is done.

The extent of the right to direct and control is a key factor in an employer-employee determination. Evidence should be gathered surrounding the "control" of the employer. One of the tools that can be utilized in gathering such information is the Employee vs. Independent Contractor Questionnaire.

➢ See Exhibit N - Employee vs. Independent Contractor Questionnaire

- Primary Categories of Evidence

Evidence can be identified within three specific categories as follows:

(a) Behavioral control – focuses on whether there is a right to direct or control how the work is done. The presence or absence of instructions and training on how the work should be done are an important indicator.

(b) Financial control – focuses on whether the business has the right to direct or control the economic aspects of the worker's activities. Facts relevant to financial control are significant investment, unreimbursed expenses, method of payment, and opportunity for profit or loss.

(c) Relationship of the parties – focuses on how the parties perceive their relationship. This can be seen in the intent of the parties/written contract, employee benefits, discharge/termination, and permanency.

- Corporate Officers

Officers are specifically included within the definition of employee for purposes of federal income tax withholding, FICA, and FUTA. Ref: IRC §§ 3121(d)(1), 3306(i), and 3401(c). The common law standard is **not** applicable.

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Generally, an officer of a corporation is an employee of the corporation. However, an officer is not considered to be an employee if two requirements are met:

(a) The officer does not perform any services or performs only minor services; and
(b) The officer is not entitled to receive, directly or indirectly, any remuneration.

The officer must meet **both** requirements to be excluded from employee status.

A director of a corporation, acting in the capacity of a director, is not an employee of the corporation for those services, even if that worker also serves as an employee or officer of the corporation for other services. In such a case, part of the compensation paid this worker can be for services rendered as an independent contractor (director) and part of the payments can be for services rendered as an employee.

S Corporation Officers – If there is an S Corp with a limited number of officers (1, 2, or 3), these officers are essentially doing the work of the corporation and should be reporting "wages paid", as opposed to "distributions" from the corporation or having received any "loans" from the Corp. It is important that such officers are reporting correctly since withholding is involved.

- Statutory Employees

Workers in four occupational groups are considered employees for FICA tax purposes, and in some instances, FUTA tax, but **not** for federal income tax withholding. Ref: IRC § 3121(d)(3). These workers are referred to as "statutory employees". The four groups include:

- Agent-drivers or commission-driver
- Full-time life insurance salespersons
- Home workers
- Traveling or city salespersons

Before a worker in one of these four groups is considered a statutory employee, three general requirements must be met as follows:

- Contract of service states that the work will be performed personally.

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- Worker has no substantial investment in facilities.
- There exists a continuing relationship between the worker and the business.

- Statutory Non-employees

By federal statute, workers in three occupations are **not** treated as employees (commonly referred to as "statutory non-employees") for purposes of federal income tax withholding, FICA, or FUTA, provided they meet specific qualifications. These three occupations are:

- Real estate agents (IRC § 3508)
- Direct sellers (IRC § 3508)
- Companion sitters (IRC § 3506)

b) State of Illinois Definition of Employee and Employer

These definitions can be found in Publication 130, Who is Required to Withhold Illinois Income Tax, which can be accessed under "Publications" on the IDOR website at www.tax.illinois.gov.

Conclusion of the Research Portion of the Compliance Check – Audit Comments

The audit comments need to clearly report the following:

- The Commence Date for the withholding tax account
- The Cease Date for the withholding tax account (if applicable)
- The Filing Status
  (Include detail as to whether the taxpayer is an annual or quarterly filer and whether or not they are in compliance. If not in compliance, the auditor needs to indicate that the case has been referred for audit.)
- The Payment Status
  (Include detail on the payment schedule the taxpayer is required to use; annual, monthly or semi-weekly. State whether or not the taxpayer is incompliance. If not in compliance, the auditor needs to indicate that the case has been referred for audit.)
- The results of the federal withholding tax audit check

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(Include whether or not the taxpayer has had a federal audit for the periods being analyzed. If the taxpayer has had a federal audit, then the auditor will need to explain whether the audit affected the withholding taxes for Illinois. If the changes do not affect Illinois, this will need to be noted. If the changes do affect Illinois, and have not been reported by the taxpayer, then the auditor needs to indicate that the case has been referred for audit).

- The results of an employee classification audit check
  (Include whether an employee classification check was necessary and the determination of that check. The auditor needs to indicate that the case has been referred for audit, if warranted by this check).

E. COMPLETION OF THE SC-137 FOR WIT REFERRAL

If the taxpayer is not in compliance for any tax type, and it is determined that an audit is warranted, the auditor will need to complete the SC-137, Audit Referral/Request, as shown below. Referral for audit should be marked. The completed, signed SC-137 should be mailed or emailed, along with required documentation, to the auditor's supervisor who will then sign and submit it to either the Income Tax Audit Planning Supervisor or the Sales Tax Audit Planning Supervisor for set up. The audit will then be assigned in-house.

For WIT audit referrals, the earliest that a referral can be setup as an audit is two months after the missing WIT return due date. This is much different than the time limitation of nine months from the extended due date for BIT/IIT audits.
The limitations period for issuing a notice of deficiency for withholding tax is April 15 of the year that is three years after the close of the calendar year during which the withholding was required. Ref: IITA § 905(j). This period may be extended by agreement. If no return was filed, there is no limitations period. Ref: IITA § 905(c).

The SC-137 can be accessed in the Audit Work Area under Forms on the Sp-IDOR web.

NOTE: When dealing with unitary taxpayers, separate SC-137 forms may need to be completed for each taxpayer not in compliance. Example: If four entities within the unitary group require separate withholding audits, then four SC-137s must be completed and submitted for those entities. A separate audit must be requested for each taxpayer that has a FEIN in GenTax.

This example SC-137 has been filled in to show the information that is required when submitting a "Referral for Audit" based on the findings of a WIT compliance

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check. **Reminder**: The Auditor ID# required on the SC-137 is the auditor's four digit AIS number.

Illinois Department of Revenue Use your mouse or Tab key to move through the fields. Use your mouse or space bar to enable check boxes.

Audit ID: _____
Control no. – Office use only

AUDIT REFERRAL/REQUEST **Earliest Statute Date:** _____ ← Enter earliest

Complete Form SC-137 and **email** it to your immediate supervisor. Also, mail a signed paper copy (required for referrals and Discovery leads) of Form SC-137, along with any supporting documentation to your immediate supervisor.

Reason: ☒ **Referral for audit** (Documentation required) ☐ **Referral for Discovery** (Documentation required) ☐ **Request for audit** (Documentation if applicable) ☐ **Request for Discovery Leads** (Documentation required)

Tax Type: ☐ Sales Tax ☐ Income Tax ☒ WIT ☐ Excise _____ ☐ Other _____

Taxpayer Name ENTER THE TAXPAYER'S NAME APE's TAX PERIODS FOR WIT AUDIT

DBA (if different) _____ Account ID _____

Address ENTER THE TAXPAYER'S ADDRESS FEIN ENTER FEIN

City, state, ZIP ENTER CITY, STATE,ZIP SSN _____

Contact person ENTER A CONTACT PERSON Telephone _____ ← Enter phone

Type of entity: ☐ 1120 ☐ 1120-ST ☐ 1065 ☐ 1040 ☐ 1041 ☐ 1023-C ☐ 990-T ☐ 1000

Business activity: ☐ Agricultural ☐ Construction ☐ Retail ☐ Services ☐ Wholesale ☐ Manufacturing

☐ Reseller ☐ Solicitation ☐ Tax Shelter Investor ☐ Tax Shelter Promoter

Select entity type.

e business activities in IL. ENTER THE MAIN BUSINESS ACTIVITIES WITHIN ILLINOIS

Did the taxpayer maintain inventory and/or a business location of any kind in Illinois? ☐ Yes ☐ No
If yes, describe the physical presence: _____

Did the taxpayer perform services or installation, construction, or repairs in Illinois? ☐ Yes ☐ No

Did the taxpayer lease tangible property or licensing rights for use in Illinois? ☐ Yes ☐ No

Did the taxpayer have a representative, agent or salesperson operating in Illinois to sell, deliver, or take orders for any tangible personal property? ☐ Yes ☐ No

Did the taxpayer make sales through the Internet, mail-order, catalogue, etc.? ☐ Yes ☐ No

All "Yes" answers must be fully discussed below or in an attachment.
Reason for referral: THE REASON FOR REFERRAL WILL BE ONE OF THE FOLLOWING:
NONFILER, SKIP FILER, WIT RAR, OR PAYMENT FREQUENCY (PENALTY & INTEREST ONLY)

If this referral originated from another audit, complete the information on the next line.

Taxpayer Name: Enter Taxpayer's name & current IT or ROT audit # Account ID/FEIN/SSN: ENTER #

Auditor's/Originator's signature: AUDITOR'S SIGNATURE ID # AUDITOR # Date: DATE

Supervisor's signature: SUPERVISOR'S SIGNATURE ID # Super # Date: DATE

☐ Rejected Comments: _____

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IV. ELECTRONIC AUDITS

A. SUBMISSION

Important Items to Keep in Mind:

1. This process does not change other functions completed in Gentax such as issuance of letters and their associated functions of the downloading of data into the STT program.
2. STT, APT and the stand alone programs will still be utilized to complete audit paperwork, however storage, submission and processing of the audit data will now be in Gentax.

Goals of this Project:

1. Savings of Resources such as paper, postage and time.
2. Increased efficiency in the processing of Audits.
3. Protection of Taxpayer Information through containment of data on secured servers and eliminated the handling of Audit data through third parties such as USPS or UPS.
4. This new process will replace Tiamat for the storage of the CAF of each audit as the CAF will be now contained within Gentax. This new process will allow CAF storage to be more orderly and better allow subsequent file users to access necessary information quickly.

Email Notifications:

Since there will **no longer be a paper file exchanged**, users will notice that email notifications will be sent at various stages to advise that an audit has been assigned to a particular user. These emails are very generic in nature and will merely advise the user an audit has been assigned or in some way changed in relation to his or her inventory or responsibility. This will be of particular importance when an audit is assigned or re-assigned to an auditor or when an audit is turned into a supervisor, passed to clerical or submitted to review and perfection.

Below is an example of the email as it displays in the inbox and the content of the email once opened.

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Wed 2/22/2017 2:58 PM

Gentax <REV.DoNotReply@illinois.gov>

Testing: ILS Audit Stage Changed

To [redacted]

This message was sent with High importance.

Enterprise Vault

Audit ID: [redacted]
Taxpayer Name: [redacted]
Filing Period From-To: 04/30/2014 - 06/30/2016
Electronic Audit File:False
Stage changed to: Rejected by RAS

This email was generated by TESTING in Gentax Environment ILS

Electronic Documents Tab

Audits will now be stored on the Electronic Documents Tab in Gentax. This was formerly known as the attachments tab. It can be found by accessing the Audit Springboard, CRM tab and Electronic Documents.

[redacted]

Each audit type will have its own index listed on this tab. This will help organize audit file and serve as guide to the auditor for the documentation that may be necessary for their audit. Below is a sample of an index.

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[redacted]

In the above example, the index is divided into sections to organize the information in a clear, concise manner. Next to each document type is an *Add* hyperlink. This is how users will add the necessary documents to the audit file. It is important to note, multiples of each document type can be added. For example, if an audit has multiple auditor reports, the user can add as many as necessary to ensure the audit is properly documented.

Adding Documents to Electronic Documents Tab

As is shown above next to each document type there is an "Add" hyperlink. To add an individual document type, the users clicks on the hyperlink and will see

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the following window appear:

Similar to most attachment functions, users will click on the blue button with the small dots to locate the file to be attached. The following window will then appear:

The user will then select the browse button which will allow them to access the various storage areas utilized (i.e. hard drive, thumb drive etc.) to retain their files until the audit is completed. The auditor then chooses the file. As seen below the file name will automatically populate on the screen.

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The user then chooses save and the previous window will display as follows with the file name prepopulated.

Note: Because the description line is still yellow, the save function will not work until a description is entered. Yellow is a REQUIRED field.

The system is designed to accept most common file types. (i.e. pdf, word, excel etc.). The user is required to give the file a name and brief description. Users should try to make the file name or at least the description easily identifiable to other users. Auditors should also be consistent in their naming conventions so that subsequent users can easily follow the flow of the audit file.

Once the file is saved it will show the time, etc. that it was saved and can be seen from the main list on the electronic documents tab.

Multiple documents can be saved for each document type. Since the intent of this project is to replace the CAF currently being stored on Tiamat, the general rule of thumb of what should be included is what is necessary to process and support your audit findings. In general your final paperwork is what will be retained in the electronic documents tab, however if multiple versions of a

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document type is necessary to understand and or process audit findings properly, then all necessary versions should be included in the Electronic Documents tab.

Ultimately when the audit is fully processed and the audit stage is changed to closed send to stores, the CAF will become read only. There will be some staff which is given the ability to add files to the CAF once it is closed however those with that security will be limited to protect the integrity of the file in the system.

Individual document types as well as a zip file from STT and APT will be savable to the system. Please keep in mind however that the individual document types **must** be saved and the zip file can be saved as a matter of procedure.

Auditor Signature of the Prod-1: Until there is a Prod-1 available to utilize an electronic signature, the auditor will print sign and scan to attach the prod-1 in the Gentax CAF.

Auditor Submission of Audit to Supervisor

Auditors will see a new button at the top of the audit springboard in Gentax labeled "*Send to Supvr*". This will appear when the audit is in the *assigned started* and the *rejected by supervisor* stages. Since the paper file is being eliminated in this new process, pressing this button when the auditor is ready to submit the audit will send the email notification to the supervisor to let him or her know there is an audit to be reviewed now in their inventory.

[redacted]

Once the audit has been submitted to the supervisor the "Send to Supvr" button will disappear from the springboard. It will not appear again unless the audit is moved to the "Rejected by Supervisor" stage or once again placed in the "Assigned Started" stage. See below.

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[redacted]

[redacted]

Procedure Change for Certain Documents Previously Included in Audit File

Changes are being made to the procedure for the submission of SC-137's, Reg 3C's and the Great Lakes Questionnaires.

Typically these items where submitted as part of the audit and then separated out as part of the processing. Since we are now moving to the Electronic CAF in Gentax, we will now be submitting certain forms directly to the appropriate areas instead of submitting with the audit file.

SC-137's will be completed by the auditor and signed by typing their name. This file can be then saved and sent directly to the supervisor. The supervisor will then also sign the form by typing their name and saving the file. Supervisors will now directly send the file via email to the appropriate planning supervisor. All Income tax requests are to be sent to [redacted]. Currently all Sales and Miscellaneous tax requests as well as Great Lakes Questionnaires should be forwarded to [redacted].

Reg 3C's should be attached via email and sent directly to [redacted], who then forwards the to the Central Registration Division.

IMPORTANT: The following changes were made to the Paperless Audit Submission indexes **effective 10/16/2017.**

- Statute Date in the Audit Manager will now show red if the statute is within:
  - 45 Days for Sales and Misc. Audits

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        - 120 Days for Income Tax Audits

    - The security has been removed for ICB attachments
    - [redacted]
- The following document types have been changed
    - IFTA
        - Added **IFTA MPG Summary Report** in Section 2
        - Added **ICB Action Decision** in Section 5
        - Added **Section 6** for Court/Litigation documents
            - **SC-7**
            - **Notice of Disposition**
            - **Final Orders**
            - **Other Documents**
    - Sales, Misc., Excise
        - Removed **EDC-20** from Section 1
        - Removed **ICB Conferee Recommendation** from Section 5
        - Renamed **Court, AH, and Tribunal** from Section 8 to Other Documents and moved it to Section 9 (see below)
        - Added **EDA-20** to Section 4
        - Added **EDA-11A** to Section 4
        - Added **EDA-11B** to Section 4
        - Added **Subpoena** to Section 4
        - Added **Section 9** for Court/Litigation documents
            - SC-7
            - Notice of Disposition
            - Final Orders
            - Other Documents (see above)
    - BIT
        - Renamed ICB Folder (AD/Recomm) to **ICB Action Decision** in Section 1
        - Added **EDA-11A** to Section 3
        - Added **Subpoena** to Section 3
        - Added **Section 4** for Court/Litigation documents
            - **IL-870-AD**
            - **Litigation EDA-25**
            - **Final Orders**
            - **Other Documents**
    - WIT

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- Renamed ICB Folder (AD/Recomm) to **ICB Action Decision** in Section 1
- Added **Section 6** for Court/Litigation documents
  - **IL-870-AD**
  - **Litigation EDA-CWTPI**
  - **Final Orders**
  - **Other Documents**

- IIT
  - Added **ICB Action Decision** to Section 3
  - Added **Section 4** for Court/Litigation documents
    - **IL-870-AD**
    - **Litigation EDA-24**
    - **Final Orders**
    - **Other Documents**

B. RECORDS RETENTION ACT

With the transition to Electronic Audits, we must be sure that we are in compliance with the Records Retention Act. For any document that an auditor intends to scan to include in an electronic audit, meaning the auditor has taken custody of that document, it must be verified as the exact image and retain the same data file integrity after it has been scanned. The process below describes when an auditor must verify the scanned document is an exact replica of the paper hardcopy.

The Audit Clerical Support Supervisor and Audit Recovery and Discovery Division Manager will approve and sign off on the certification and approve these documents for destruction.

What does this mean to you?

- If an auditor receives a document electronically from a taxpayer *there is no verification needed.*

- If a taxpayer provides a document, and the auditor scans it to an electronic format, but gives said document back to the taxpayer, *there is no verification needed.* (The auditor is not taking custody of this document.)

- If a taxpayer provides a document, we scan to electronic format, and we retain that document or take custody of that document for the audit, <u>then verification and destruction is required</u>. Therefore, when documents are scanned in the field, the auditor shall use the attached list to record those scanned documents and affix a certification page for each verification

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sheet. You must include the numbers of pages scanned for each document. **See example below:**

Image Verification for the Destruction of Imaged Audit Correspondence. (10/25/2016)

List the document information for each image verified. Acknowledgments are to be signed off with each completed form.

Account	# of Pages	Return/Project Type	Image verified: Each Page (Y or N)	Re-scan Required (Y or N)
[redacted]	3	1040	Yes ☑ No ☐	Yes ☑ No ☐
	4	1120	Yes ☑ No ☐	Yes ☑ No ☐
	4	1065	Yes ☑ No ☐	Yes ☑ No ☐
	24	1120ST	Yes ☑ No ☐	Yes ☑ No ☐
	11	ROT	Yes ☑ No ☐	Yes ☑ No ☐
	5	ROT	Yes ☑ No ☐	Yes ☑ No ☐
	7	ROT	Yes ☑ No ☐	Yes ☑ No ☐
			Yes ☐ No ☐	Yes ☐ No ☐
			Yes ☐ No ☐	Yes ☐ No ☐
			Yes ☐ No ☐	Yes ☐ No ☐

This document confirms that I have verified the image integrity in the Gentax system for each batch and document listed above. The images produced are true copies of the documents found in the record files and are in accordance with the regulations and standards of the State Records Commission. I approve physical documents listed may be destroyed in accordance with the proper IDOR Retention Schedule and Records Management Procedures.

Printed Name	Signature	Date
Auditor name		11/02/2017

REVISED
11:51 am, Nov 01, 2017

Auditors must sign the verification sheet and then mail together with the originals for approval and destruction here at the WIB. See attachment A and attachment B.

Mail to: IL Dept. of Revenue
Audit Clerical Support Supervisor
101 W. Jefferson, Mail Code 3-329
Springfield, IL 62702

- If the documents are in excess of 50 pages, please use the attached scanning request to mail the documents to our clerical unit for scanning. Depending on the quantity, the scanned documents will either be returned via email or placed on the network with auditor notification so the auditor can then include in the electronic audit file. See attachment C.

NOTE: In-house Discovery Section: your procedures will remain the same. This does not impact or change current shred procedures. **DO NOT send shred information in with the verification sheets or document request.**

When and where possible please try to obtain electronic documents from the taxpayer which will eliminate the need to do the verification process.

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Attachment A

Certification of Verification and Approval for Destruction of Imaged Documents

Audit Files

The Illinois Department of Revenue's (IDOR) Audit Bureau certifies that processing has been completed (including verification) for all imaged Audit Bureau documents specifically listed on the attached _____ pages.

This document confirms that I, along with personnel under my direct supervision, have verified the image and data file integrity for all documents listed on the attached. The images produced are true copies of the documents and are in accordance with the regulations and standards of the State Records Commission.

I approve the physical documents on the attached listing may be destroyed in accordance with the proper IDOR Retention Schedule and Records Management (RMD) Procedures.

Printed Name	Signature	Date
_____	_____	_____
Audit Bureau Supervisor		
_____	_____	_____
Audit Bureau Management		

Received in RMD by:

_____	_____	_____
RMD Representative		

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Attachment B

Image Verification for the Destruction of Imaged Audit Correspondence. (10/25/2016)

List the document information for each image verified. Acknowledgments are to be signed off with each completed form.

Account	# of Pages	Return/Project Type	Image verified: Each Page (Y or N)	Re-scan Required (Y or N)
			Yes ☐ No ☐	Yes ☐ No ☐
			Yes ☐ No ☐	Yes ☐ No ☐
			Yes ☐ No ☐	Yes ☐ No ☐
			Yes ☐ No ☐	Yes ☐ No ☐
			Yes ☐ No ☐	Yes ☐ No ☐
			Yes ☐ No ☐	Yes ☐ No ☐
			Yes ☐ No ☐	Yes ☐ No ☐
			Yes ☐ No ☐	Yes ☐ No ☐
			Yes ☐ No ☐	Yes ☐ No ☐
			Yes ☐ No ☐	Yes ☐ No ☐

This document confirms that I have verified the image integrity in the Gentax system for each batch and document listed above. The images produced are true copies of the documents found in the record files and are in accordance with the regulations and standards of the State Records Commission. I approve physical documents listed may be destroyed in accordance with the proper IDOR Retention Schedule and Records Management Procedures.

Printed Name	Signature	Date

REVISED
11:51 am, Nov 01, 2017

Attachment C

DOCUMENT SCANNING REQUEST

The purpose of this request is for field auditors needing to scan more than 50 sheets of paper in order to include a document(s) in the electronic audit file. Please take time and prepare the documents for scanning. All paper clips and **staples must be removed**. Separate each document with binder clips or rubber bands for each file. Make sure the paper is free of folds, debris and etc. Depending on the quantity, scanned documents will either be returned via email or placed on the network with auditor notification. Please complete the requested information below for each document.

Account#Audit ID:

Auditor Name:

Number of pages in this document:

Name of this document for file folder:

Does this document contain FTI? ☐ YES ☐ NO

Mail to:

Audit Clerical Support Supervisor
101 W. Jefferson MC 3-329
Springfield, IL 62702

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V. REASONABLE CAUSE

A. INTRODUCTION

This chapter is to be used when considering a taxpayer's request for abatement of penalties established by the Uniform Penalty and Interest Act due to "reasonable cause". This chapter replaces all reasonable cause sections in all other Audit Manual chapters. This chapter provides the guidance and procedures for Audit Bureau staff to follow to make uniform abatement decisions on penalties assessed in an audit.

[redacted]

The State of Illinois imposes penalties for the failure to file tax or information returns or to pay taxes within the time prescribed by statute. The State of Illinois also imposes interest on any unpaid tax liabilities. The Uniform Penalty and Interest Act (UPIA) [35 ILCS 735] authorizes the assessment of interest and penalties.

Section 3-8 of the Uniform Penalty and Interest Act [35 ILCS 735/3-8] provides that the Illinois Department of Revenue can abate some imposed penalties if the taxpayer can demonstrate reasonable cause for the noncompliance. UPIA does not authorize the Department to abate interest. The associated regulations on reasonable cause for the abatement of penalties can be found in 86 Illinois Administrative Code 700.400. The standards in this Regulation are intended to be used for the abatement of UPIA penalties only.

Contact the appropriate Technical Support Section for instructions on how to process Reasonable cause requests for Pre-UPIA penalties and non-UPIA penalties.

B. UPIA PENALTIES **ELIGIBLE** FOR REASONABLE CAUSE ABATEMENT

AUDIT RELATED

- Late filing, failure to file, or late payment penalty [35 ILCS 735/3-3];
- Negligence penalty [35 ILCS 735/3-5].

OTHER

- Failure to file a correct information return penalty [35 ILCS 735/3-4];

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- Bad check penalty [35 ILCS 735/3-7.5].

C. UPIA PENALTIES **NOT ELIGIBLE** FOR REASONABLE CAUSE ABATEMENT:

- Personal liability penalty [35 ILCS 735/3-7];
- Collection penalty [35 ILCS 735/3-4.5];
- Fraud penalty [35 ILCS 735/3-6].

D. NON-UPIA PENALTIES

1. **NOT ELIGIBLE** FOR REASONABLE CAUSE ABATEMENT

- Abusive Tax Avoidance Transaction (ATAT) - (35 ILCS 5/1007 & 1008)
- **The penalty imposed under the Retailers' Occupation Tax Act for improper use of a** Building Materials Exemption Certificate.

2. **ELIGIBLE** FOR REASONABLE CAUSE ABATEMENT

- Reportable transaction penalty in 35 ILCS 5/1005(b)(4)

3. **ELIGIBLE** FOR REASONABLE CAUSE ABATEMENT

- Reportable transaction penalty in 35 ILCS 5/1005(b)(4)

E. REASONABLE CAUSE - PENALTY ABATEMENT - AUDIT BUREAU

The term reasonable cause is commonly defined as a good faith effort to exercise ordinary business care and prudence in the reporting of one's tax obligations.

The term good faith commonly refers to an honest belief void of any knowledge that would put a taxpayer on notice **to inquire further as to his or her tax responsibilities, coupled with the absence of any intention** to commit fraud.

Ordinary business care and prudence generally means the amount of care that a reasonably logical person would take under similar circumstances, given the knowledge, experience and sophistication of the taxpayer.

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Ordinary business care and prudence depends upon the:

- clarity of the law,
- the interpretation of the law (as analyzed by Illinois Appellate or Supreme Court cases),
- taxpayer's experience,
- taxpayer's knowledge, and
- taxpayer's level of education

The Audit Bureau may grant reasonable cause on certain penalties assessed in an audit or on outstanding balances.

There are two separate categories that the Audit Bureau will consider penalty abatement for under Reasonable Cause. They are:

1) Reasonable cause based on error percentage within established limits; and

2) all other reasonable cause requests.

- **AUDIT ERROR RATE LESS THAN** [redacted]

[redacted]

- **OTHER REASONABLE CAUSE REQUESTS**

[redacted], other factors may qualify a taxpayer for reasonable cause consideration. Some examples are as follows:

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- Death or serious illness of a taxpayer or tax preparer
- Natural disaster
- Unavoidable absence of a taxpayer or tax preparer
- Inability to timely obtain records or computer failure
- Reliance upon written advice from the Department
- Reliance upon the erroneous advice of a competent tax adviser
- Embezzlement or employee fraud

[redacted] This is located on the Sp-IDOR web.

- **CONSIDERING REASONABLE CAUSE REQUESTS**

When evaluating reasonable cause requests, the reviewer must use the [redacted] and the reasonable cause regulations (86 Illinois Administrative Code 700.400) in determining whether reasonable cause should be approved.

F. AUDIT PROCEDURES FOR REASONABLE CAUSE PENALTY ABATEMENT

The following procedures must be utilized to request approval for abatement of UPIA and/or pre-UPIA penalties where reasonable cause exists.

All taxpayer requests for reasonable cause penalty abatement must be in writing, which includes letters, emails and facsimiles.

Auditors are not allowed to accept oral requests for reasonable cause penalty abatement. The taxpayer must also submit documentation which supports the taxpayer's contention that reasonable cause should be granted. The best documentation that can be provided by the taxpayer are **evidentiary documents that can be admitted** into evidence at a hearing or trial.

The field auditor can initiate the approval process, but cannot give final approval until it is approved by higher management levels.

Abatement of penalties assessed in an audit will be considered in the following circumstances:

- The overall error rate is within a predetermined tolerance level, or

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- **The error rate may exceed the tolerance level but other factors exist where the taxpayer** may qualify for reasonable cause consideration.

There are different approval procedures for each of these circumstances.

NOTE: Reasonable cause abatement does not apply to Federal Revenue Auditor's Reports (RARs) which follow the established rules that govern Federal Revenue Auditor's Report (RAR) penalties.

When the result of a federal income tax audit is reported and paid within 120 days of federal finalization, no penalty is due. However, when the taxpayer made an error reporting the RAR changes that resulted in more tax due than was reported, penalty is assessed on any such amount and should not be adjusted. Penalty abatement for reasonable cause may be warranted in such a case.

STEP 1 - TAXPAYER NOTIFICATION OF LIABILITY

Once the auditor has determined that a tax liability may exist, the auditor must explain all penalties and notify the taxpayer that they may make a request for the abatement of penalty under the Reasonable Cause guidelines. It is encouraged that the taxpayer submit a request for the abatement of the penalty as early in the audit process as possible. The Reasonable Cause request should be received, reviewed, and replied to prior to the issuance of the following ICB standardized letters:

Income Tax:

- Form EDA-122 - Notice of Proposed Deficiency;
- Form EDA-124-I - Notice of Proposed Tax Liability and Claim Denial; or
- Form EDA-125-I - Notice of Proposed Claim Denial

Sales Tax:

- Form EDA-123 - Notice of Proposed Liability,
- Form EDA-124-S - Notice of Proposed Tax Liability and Claim Denial, or
- Form EDA-125-S - Notice of Proposed Claim Denial

[redacted]

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STEP 2 - REASONABLE CAUSE BASED ON ERROR PERCENTAGE

If the error rate exceeds the error rate penalty abatement threshold go to Step 3.

The taxpayer's error rate should be within ordinary business care and prudence which can be demonstrated by the accuracy of the taxpayer's returns and their effort in applying tax law correctly. The error percentage threshold limits are as follows:

- [redacted]
- [redacted]

[redacted]

[redacted]

- [redacted]
- [redacted]

[redacted]

- [redacted]
- [redacted]
- [redacted]

For example, the taxpayer is a retailer with the majority of sales made to exempt organizations and resellers (resale certificates) and pays a minimal amount of ROT. The audit sample error rate is 2.5%. The projected additional tax liability causes the percentage change on tax paid to be 25% because the taxpayer paid a minimal amount of tax on his returns. The auditor and RAS will have to determine which error rate more accurately reflects the taxpayer's compliance with the tax laws and regulations.

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a) ERROR PERCENTAGE CALCULATION – percentage change on tax paid

The error percentage is based on the amount of increased liability assessed in the audit divided by the dollar amount that the taxpayer paid in the audit period. Examples are as follows:

[redacted]

[redacted]

[redacted]

b) ERROR PERCENTAGE CALCULATION – percentage of sample error

Auditors must select accounts to sample which have a taxable basis. (e.g., sales, fixed asset purchases, consumable supply purchases, etc.)

The sample error percentage is based on the total dollar amount of exceptions divided by the total dollar amount of the sample size. This is the case regardless of the type of exam that is made (Detail, % of error, Average Error per Unit, or CAA). In a non-CAA sample the auditor will have to determine the appropriate accounts to sample and have the totals for the sample periods to determine the error rate percentage. Examples are as follows:

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[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

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[redacted]

In this example, Reasonable Cause might be approved for sales because the error rate is within the established limit and denied for purchases because **the error rate is above the established limit.**

c) AUDITOR PROCEDURES - ERROR RATE

1) Auditors must calculate the error rate percentage and submit a recommendation along with the taxpayer's abatement request to their Supervisor who will then recommend to the Assistant Division Manager for approval or denial.

   It is important that abatement thresholds must never be shared with the taxpayer.

2) The Audit Narrative and EDC-5 must fully explain in detail the rationale for either approving or denying penalty abatement.

The auditor must ensure that the taxpayer's written request for reasonable cause and any documents pertaining to the request (including: work papers, analysis or decision making done in the audit) be retained and included in the audit file.

NOTE: It is important to properly address and document any reasonable cause request at the audit level because the decision is intended to be used in the Board of Appeals analysis if the taxpayer makes a request for a BOA review.

3) The auditor will complete all of the audit reports.

- **If reasonable cause is not approved,** the taxpayer can disagree with the finding and file for an ICB hearing. If the taxpayer accepts the denial and still agrees with the audit findings, the auditor will complete and update the penalty schedule. The penalty will then be on the audit report (IL-870, EDA-105, etc.).
- **If reasonable cause is approved,** the auditor will complete all of the audit reports. The amount of approved abated penalty will not be shown on the final Auditor Reports issued to the taxpayer (e.g., EDA-105, IL-870, etc.). Auditors will code the PROD-1 with the "RC" (reasonable cause) liability code and the "NP" (+/-, Negative/Positive Change) liability code. See Step 4 of this section for instructions on completing the PROD-1 when reasonable cause has been granted.

4) **If abatement is approved,** the auditor must show the abatement on the outside of the audit folder to notify Audit Review and Perfection that penalty relief should be

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given. When Perfection enters the audit return information into GENTAX, GENTAX will apply the penalty. The penalty will have to be adjusted manually.

STEP 3 - ABATEMENT DUE TO REASONS OTHER THAN ERROR RATE – PROCEDURES

1) The taxpayer must submit a detailed written explanation of the reasonable cause circumstances to the auditor. Any documentation, affidavits, or other information which supports the reasonable cause statement must also be provided.

2) Upon receipt of the reasonable cause statement, the auditor and the audit supervisor will review the statement and supporting facts. The auditor and the audit supervisor will make a recommendation of whether or not they feel that reasonable cause exists. The taxpayer's reasonable cause statement, supporting information and the auditor and supervisor's recommendation must be forwarded to the Assistant Division Manager.

3) The Assistant Division Manager will review the recommendation, make a notation of whether he or she agrees or disagrees with the recommendation and send it for final review and approval to the Division Manager. If the reasonable cause request is approved by the Division Manager, the auditor will then complete the audit allowing the reasonable cause abatement.

4) If the Division Manager does not feel that reasonable cause exists, he will deny the reasonable cause statement and return it to the auditor/supervisor. The auditor will then complete the audit following normal audit procedures. If the taxpayer disagrees with the denial of reasonable cause, the taxpayer would still have the option of requesting an ICB hearing. (The taxpayer still has the right to pursue the reasonable cause argument at the conclusion of the audit through normal protest and/or litigation means.) The information, analysis and reasons for denial should be provided to the area (ICB, BOA, etc.) that has jurisdiction to consider reasonable cause if the taxpayer disagrees with the denial.

5) The Audit Narrative must fully explain the rationale for either approving or denying penalty abatement. It is important for the auditor to provide detailed information as to the determination on approval or denial.

6) The auditor will complete all of the audit reports. The auditor will follow the same procedures as in 3.6.2.2 above.

7) If abatement is approved, the auditor must show the abatement on the outside of the audit folder to notify Audit Review and Perfection that penalty relief should

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be given. When Perfection enters the audit return information into GENTAX, GENTAX will apply the penalty. The penalty will have to be adjusted manually.

STEP 4 – COMPLETING THE PROD-1 WHEN REASONABLE CAUSE HAS BEEN GRANTED

The "NP" code will be used for both Income Tax and Sales Tax to properly record the penalty abatement in GENTAX so that it doesn't impact the Audit Results by Division reports or auditor's production totals.

Auditors will enter the following codes on the PROD-1:

- "RC" and the abated penalty amount shown as a negative number (e.g., -1000)
- "NP" and the abated penalty amount shown as a positive number (e.g., +1000)

The following example shows how Parts 1 and 2 of the PROD-1 will appear:

EXAMPLE PROD-1

Part 1: Additional Liability by Period

Area: 206 Federal RAR Change	Code: AL	Amount: $	500
Area: 240 Apportionment Change	Code: AL	Amount: $	500
Area: 96 Interest	Code: AL	Amount: $	56
Area: 98 Penalty	Code: NP	Amount: $	150
Area: 98 Penalty	Code: RC	Amount: $	(150)

Part 2: Status of Additional Liability Code

	Code: AL	Amount: $	1056
	Code: NP	Amount: $	150
	Code: RC	Amount: $	(150)
Total Additional Liability		$	1056

1. PENALTY ABATEMENT ON OUTSTANDING BALANCES

There may be instances in which the taxpayer wants penalties abated that are included in the balances on the Taxpayer Statement. This includes penalties assessed by front end processing for late filing, failure to file, late payment and bad check penalties. These requests are subject to the approval process in Step 3 of this section – Abatement Due to Reasons Other Than Error Rate.

Each assessment will be evaluated individually and each one must have its own reasonable cause request. The [redacted] error rate threshold for abatement of penalty is only for penalties assessed in an actual audit and must be requested separately from other requests.

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Penalties for these types of outstanding balances will only be abated if it is the same issue as was in the audit other than the error rate threshold.

Once reasonable cause has been approved on an outstanding balance, the auditor is to prepare a memo indicating the letter number(s) and stating that the penalty is to be abated per an approved reasonable cause request. The Revenue Audit Supervisor has to approve the memo prior to the case being transmitted to Audit Review. Reasonable cause penalty abatement on outstanding balances cannot be done via the auditor reports (e.g., EDA-105, IL-870) or the PROD-1. Audit Review and Perfection will make the appropriate adjustments in GENTAX and add a CRM note explaining the reason for the adjustment.

a) PAID OUTSTANDING BALANCES

The auditor can make adjustments in the audit on the amount of tax properly due if necessary (i.e. tax liability reduced or additional tax liability).

b) UNPAID OUTSTANDING BALANCES

The auditor can make adjustments in the audit on the amount of tax properly due if necessary (i.e. tax liability reduced or additional tax liability).

If the outstanding balance is in the Collection stage and reasonable cause has been granted, Audit Review and Perfection will need to place a stop bill indicator on the account to remove the periods from Collection and to stop the collector from pursuing the outstanding balance until the adjustments are made.

NOTE: Regardless of the Reasonable Cause status, all outstanding balances are required to be collected in accordance with AMU IT12-11 and ST12-06, Audit Liability Payments and Assessment Collection Payments. For income tax, this AMU has been incorporated into Audit Manual Chapter 20.

c) SPECIFIC AUDIT ISSSUES

- Two-Year Good Filing History Provision- Department policy is to abate both late file and late pay penalties for a taxpayer with a two-year good filing history. This provision only applies to original returns and would not apply to underreporting seen in an audit.

- Reliance on previous Audit issues should not be the sole reason for penalty abatement unless the same fact pattern exists in the follow-up Audit.

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VI. AMNESTY

A. PURPOSE

The purpose of this chapter is to provide information concerning the 2010 and 2003 Illinois Tax Amnesty Programs. The chapter is divided into the two main sections, the first examining the 2010 Amnesty Program (Section III) and the second explaining the 2003 Amnesty Program (Section IV).

B. REFERENCE SOURCES

1. TAX DELINQUENCY AMNESTY ACT

- 35 ILCS 745/

2. ILLINOIS REGULATIONS

- IAC § 520.101
- IAC § 520.105

3. UNIFORM PENALTY AND INTEREST ACT

- 35 ILCS 735 § 3-2(f), (g) and (h)
- 35 ILCS 735 § 3-3(i) and (j)
- 35 ILCS 735 § 3-4(d) and (e)
- 35 ILCS 735 § 3-5(d) and (e)
- 35 ILCS 735 § 3-6(c) and (d)
- 35 ILCS 735 § 3-7.5(b) and (c)

4. DEPARTMENT PUBLICATIONS

- Informational Bulletin FY 2004-11 – Tax Delinquency Amnesty Act (2003)
- Informational Bulletin FY 2005-10 – Refund Claims for RAR Liabilities Paid Under Amnesty (2003)
- The FACT sheet - Amnesty Questions and Answers (2010), was available on the Department's web site (link has been removed so no longer accessible).

- Throughout the chapter this "bullet style" has been used to indicate when an Exhibit should be reviewed at the end of the chapter. Exhibits have been hyperlinked.

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C. 2010 ILLINOIS TAX AMNESTY PROGRAM

Public Act 96-1435 amended the Tax Delinquency Amnesty Act and directed the Department of Revenue to implement an Amnesty program in 2010. The program allowed taxpayers with contested and uncontested tax liabilities who paid the tax in full during the Amnesty Program Period to have the related penalties and interest abated. Taxpayers who did not pay the full tax during the Amnesty Program Period may be subject to double penalties and interest on the unpaid tax liability. Ref: 86 Ill. Admin. Code § 520.101(a) and 35 ILCS 745/10 § 10 Amnesty Program.

1 GENERAL INFORMATION

The Amnesty Legislation did not require the Department to send taxpayers written notification of Amnesty. However, the Department did send a system-generated notice to every taxpayer that had an outstanding processed liability. In addition, the Audit Bureau sent a notice to every taxpayer that was under audit (including ICB cases), had an audit completed but not processed, or that was in unassigned inventory available for selection. The FACT sheet – Amnesty Questions and Answers was available on the Department's web site (link has now been removed) to answer taxpayer questions about the 2010 Amnesty Program. Amnesty regulations are available on the Department's web site (http://www.iltax.com/LegalInformation/regs/part520/).

Note: The regulation, rules, and audit procedures are significantly different for the 2010 Amnesty program when compared with the 2003 Amnesty program.

5. DEFINITIONS

The following definitions are used throughout this chapter:

a) "Eligible Liability"

A tax liability with respect to which a taxpayer may participate in the Amnesty Program. The Eligible Liability is the actual amount due for a period whether known or unknown. Ref: 86 Ill. Admin. Code § 520.105(h).

b) "Established Liability"

An Eligible Liability that was assessed or became final prior to October 1, 2010 (start of the 2010 Amnesty Program Period). Typically, this means the taxpayer received an audit

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return (EDA-105-R, IL-870, etc.) after the completion of an audit (including any proceedings before the Informal Conference Board), Notice of Assessment, Notice of Tax Liability, Notice of Deficiency, or other final bill. The Established Liability is the known amount due for a tax period prior to the start of the Amnesty Program Period. Ref: 86 Ill. Admin. Code § 520.101(b)(5).

c) "Amnesty Program Period"
The time period during which the taxpayer was required to pay an Eligible Liability. The published dates were from October 1, 2010, through November 8, 2010, but the Department established a grace period which allowed returns and payments received from September 6, 2010 through November 15, 2010 to also qualify.

d) "Additional Liability"
An additional amount of tax determined to be due after the Amnesty Program Period for a period in which a taxpayer participates in Amnesty.

e) "200% Sanction"
The doubling of the rates of penalty and interest imposed on a taxpayer with an Eligible Liability who fails to participate in Amnesty.

f) "Estimated Federal Change Liability"
An Eligible Liability that a taxpayer estimates will result from a Federal Change that has not become final under IITA § 506(b) as of the end of the Amnesty Program Period.

g) "Notice and Demand"
Any demand for payment issued by the Department that is eligible for the 30-day interest-free grace period under UPIA § 3-2(c-5). This is typically the audit return (EDA-105-R, IL-870, etc.). [Note: The EDA-105 and IL-870 are no longer viewed as a notice and demand, but were considered as such during Amnesty.]

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h) "Protest Act"
The State Officers and Employees Money Disposition Act [30 ILCS 230] which allows a taxpayer to challenge a liability in civil court.

i) "Taxable Period"
The period of time for which any tax is imposed by and owed to the State of Illinois. (ITDAA § 5)

j) "Federal Change"
A change affecting the taxpayer's federal income tax liability that must be reported to the Department under IITA § 506(b).

k) "Amnesty Issue"
An Amnesty Issue is every issue of law that must be resolved in determining the amount of an Eligible Liability paid during the Amnesty Program and all facts relevant to those issues, as in existence as of the end of the Amnesty Program Period.

6. ELIGIBLE TAX PERIODS, PARTICIPATION PERIOD, AND PROVISIONS

Tax periods eligible for Amnesty treatment included those ending after June 30, 2002, and prior to July 1, 2009.

The Amnesty payment period (also referred to as the Amnesty Program Period) ran from October 1, 2010, through November 8, 2010.

For **ROT annual** filers, all 2002 receipts received in a tax period ending after June 30, 2002, would qualify for Amnesty; however, all 2009 receipts received in a tax period ending after June 30, 2009, would not qualify for Amnesty.

Unless specifically excluded, taxpayers were eligible to participate in the Amnesty Program as explained in 86 Ill. Admin. Code § 520.105(b)(1) of the Amnesty Regulations:

A taxpayer may participate in the Amnesty Program **selectively**, provided that the taxpayer completely satisfies its Eligible Liability for the tax type and tax period for which amnesty is sought. Thus, a taxpayer may participate in the Amnesty Program with respect to:

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A) Particular types of tax liability, but not others (e.g., Illinois Income Tax, but not Illinois Retailers Occupation Tax), or

B) Particular tax periods but not others (e.g., 2003 Illinois Income Tax but not 2004 Illinois Income Tax).

If the taxpayer paid its full Eligible Liability during the Amnesty Program Period, the Department abated and did not seek to collect any interest or penalties applicable to that liability. The Department also did not seek civil or criminal prosecution for any taxpayer for the period of time for which Amnesty was granted. However, a taxpayer, with an Eligible Liability, who failed to participate in the Amnesty Program, would be subject (with a few exceptions) to the 200% Sanction on that liability.

If the taxpayer or the Department determines after the Amnesty Program Period the taxpayer owes an additional liability for a period, the taxpayer may preserve the abatement of penalties and interest on any amount paid during the Amnesty Program Period by paying the additional liability plus the 200% Sanction on that liability. If the taxpayer unsuccessfully contests the additional tax liability or fails to pay the additional tax, penalties and interest within 30 days of receiving a Notice and Demand for payment (audit return), the abatement of penalties and interest on the amnesty payment is forfeited and the taxpayer is also subject to the 200% Sanction on any tax liability paid for that period during as well as after the Amnesty Program Period.

7. TAXES/FEES QUALIFYING AND NOT QUALIFYING FOR AMNESTY

a) Taxes/Fees That Qualify

Amnesty applies to all taxes, except for Motor Fuel Use Tax (IFTA), collected by the Department of Revenue, such as Retailers' Occupation, Use, Income, Replacement, Liquor, Cigarette, Hotel, Chicago Soft Drink and other miscellaneous taxes. Ref: 86 Ill. Admin. Code § 520.105(h).

Amnesty does not include taxes that are collected by other Illinois agencies or local municipalities such as corporate franchise taxes, insurance company premiums taxes, unemployment taxes, or local property taxes.

b) Taxes/Fees (and Penalties) That Do Not Qualify

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Lien filing and lien release fees, forfeited retailers' discounts, and over-collections of Use Tax that are required to be remitted to the Department by reason of § 2-40 of the ROT Act are not penalties and were not eligible for abatement.

Collection agency fees that are added to a taxpayer's tax liability are not "penalties", but are tax liabilities that may be eligible liabilities. If referred to a collection agency, the collection agency's fees must be paid during the Amnesty Program Period in order for the taxpayer to qualify for abatement of penalties and interest. Also, reimbursements of collection agency expenses incurred by the Department, when those expenses are deemed by statute to be part of the related tax liabilities are part of the Eligible Liability which must be paid during the Amnesty period.

Responsible officer penalties for failure to collect, account for, and pay over trust taxes are penalties imposed on the responsible officer, even when the amount of the penalty includes unpaid tax and interest. As such, they are ineligible for abatement because there is no related tax liability for the responsible officer to pay. However, a responsible officer's employer could have participated in the Amnesty Program. If the underlying trust tax liability of the employer was paid under the Amnesty Program, penalties and interest would be abated, and the responsible officer penalty would be zero.

In periods where there was no remaining unpaid tax liability, outstanding penalties and interest did not qualify for Amnesty.

8. PENALTIES THAT **QUALIFY** FOR ABATEMENT

Late payment, late filing or failure to file, collection, negligence, fraud, bad check, and tax shelter penalties were eligible for abatement. Abatement of penalties and interest was based on the period, and not the payment. Therefore, penalties and interest from previously assessed tax liabilities which were still **unpaid** during the Amnesty Program Period were also eligible for abatement if the Eligible Liability was paid during the Amnesty Program Period.

> **Example:** Taxpayers had a $1,000 tax liability on their 2008 income tax return. They filed the return timely but did not pay the tax liability and were assessed a late payment penalty and interest on the $1,000 liability. In December 2009, the taxpayer paid $700 which was applied to the tax liability. If the taxpayer pays the remaining $300 tax liability during the Amnesty Program Period,

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they will receive abatement on the penalties and interest that were assessed on the original $1,000.

As stated above, tax shelter penalties were eligible for abatement. However, in a situation where the taxes have been paid before the Amnesty Program Period, ATAT penalties would not qualify for abatement.

Example: An auditor assessed ATAT penalties on the $10 million of taxes paid with Forms IL-1120-X for tax years 2007 and 2008, which were filed by the taxpayer on December 30, 2009 (taxes were paid well before the 2010 Amnesty Program Period began). During the Amnesty Program Period, the taxpayer filed a subsequent set of amended returns for both years and paid additional taxes of $1 million with the returns on October 30, 2010. The taxpayer contended that the payment made during Amnesty would preclude the auditor from imposing ATAT penalties on the original $10 million paid on December 30, 2009. However, the taxpayer is incorrect and may only have abatement on the penalty and interest associated with the $1 million liability paid during the Amnesty Program Period. Ref: 86 Ill. Admin. Code § 520.105(h)(1).

9. PENALTY AND INTEREST ONLY LIABILITIES

Amnesty participation was not allowed for taxpayers who only owed penalty and/or interest. Ref: 86 Ill. Admin. Code § 520.105(h)(1).This occurred when a taxpayer had paid all of the tax liability due for a period, but had not yet paid all of the penalty and interest related to the liability. Since these taxpayers could not participate in Amnesty, the 200% Sanction did not apply.

Example: Taxpayers had a $1,000 tax liability on their 2008 income tax return. They filed the return timely but did not pay the tax liability and were assessed a late payment penalty and interest on the $1,000 liability. On December 22, 2009, the taxpayer paid only the $1,000 tax liability. By the start of the Amnesty Program Period, they had not paid the penalties and interest. An audit concluded on October 15, 2010, established an additional $100 tax liability for 2008. If they signed the audit return and paid the additional $100 tax liability before the end of the Amnesty Program Period, the Department would abate penalties and interest related to the additional $100 liability, but not the interest and penalties (standard rate) related to the original $1,000 liability.

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10. PARTICIPATION IN AMNESTY

No application was required for Amnesty participation. In order to qualify for Amnesty, taxpayers must have had an outstanding Eligible Liability for a tax period covered under the Amnesty Program. These included taxpayers who:

1) Had a tax liability associated with an audit, including those that were currently assigned or in Technical Review?

2) Had unreported liabilities in periods not under audit.

3) Had unpaid tax assessments (Established Liabilities).

4) We're participating in the ICB process. (See the "Amnesty and ICB" section below for details)

5) Were in Administrative Hearings. In order to participate in the Amnesty Program, a taxpayer in Administrative Hearings had to withdraw and stipulate to judgment in favor of the Department and pay the tax during the Amnesty Program Period.

6) Were in bankruptcy. However, since taxpayers in bankruptcy were likely unable to get court and creditor approval in time to pay the required tax within the Amnesty Program Period, the 200% Sanction does not apply.

11. ELIGIBLE VS ESTABLISHED LIABILITIES

There are two significant differences between the treatment of an Established Liability and other Eligible Liabilities.

First, as a general rule, a taxpayer who failed to pay all of an Eligible Liability would be subject to the 200% Sanction only on the amount they failed to pay as long as they paid all additional tax, penalties, and interest within 30 days of receiving a notice and demand for payment of the additional amount. Audit reports such as the EDA-105 and IL-870 qualify as notice and demands. (Note: The EDA-105 and IL-870 are no longer viewed as a notice and demand, but were considered as such during Amnesty.)

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In contrast, a taxpayer who failed to pay all of an Established Liability during the Amnesty Program Period did not qualify for abatement of penalties and interest, and was subject to the 200% Sanction on its entire liability.

Second, participation in the Amnesty Program generally did not bar refund claims. However, in the case of an Established Liability, no refund was allowed unless it resulted from an issue that was unrelated to the Amnesty payment or from a federal change (RAR) to the taxpayer's income tax liability, which became final after Amnesty.

Taxpayers with an Established Liability needed to pay that tax liability in full during the Amnesty Program Period to qualify for abatement of penalties and interest.

Taxpayers with an Eligible Liability (that was not an Established Liability) needed to file the appropriate original or amended returns, and pay the tax liability shown on the return (plus any Established Liability for that tax and period) in full during the Amnesty Program Period to qualify for abatement of penalties and interest.

12. CONSEQUENCES FOR FAILURE TO PARTICIPATE – 200% SANCTION

A taxpayer who failed to pay the full amount of an Established Liability during the Amnesty Program Period had the 200% Sanction imposed on the full liability. They did not receive amnesty on any partial payments made during the Amnesty Program Period.

A taxpayer who failed to pay any portion of an Eligible Liability (other than an Established Liability) during the Amnesty Program Period would have the 200% Sanction imposed on that unpaid portion. If the taxpayer paid the unpaid portion of the tax, with the related penalties, and interest (including the 200% Sanction) within 30 days of receiving a notice and demand for payment, the taxpayer maintained the abatement of penalties and interest on any portion paid during the Amnesty Program Period. If the taxpayer failed to pay the unpaid portion of the tax, penalties, and interest within 30 days of receiving a notice and demand for payment, they were also subject to the 200%
Sanction on the portion of the liability paid during as well as after the Amnesty Program Period.

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Note that the 200% Sanction did not apply to RAR liabilities for any period covered by the 2010 Amnesty Program, even if the change was not timely reported or the payment was made beyond 120 days of the finalization date.

13. REQUIREMENT TO FILE RETURNS

For Eligible Liabilities which were not assessed or otherwise subject to collection action by the Department before the end of the Amnesty Program Period, the taxpayer was required to **file and pay** the appropriate original or amended return for that liability, during the Amnesty Program Period, in order to participate under Amnesty. Taxpayers who made a payment during the Amnesty Program Period without filing a return were subject to the 200% Sanction.

Taxpayers who filed one return for multiple periods (Sales Tax) were only eligible for Amnesty on one of those periods.

> **Example:** A taxpayer who was required to file monthly sales tax returns filed one return covering January – December 2008 and paid the reported liability during the Amnesty Program Period. Even if the payment was enough to cover the full liability, the taxpayer would only qualify for Amnesty in one month.

Auditors should have allowed Amnesty on the period that was most beneficial to the taxpayer (per Sales Tax policy).

AMNESTY BY PERIOD

Each period had to be evaluated separately to determine whether it qualified for Amnesty. A taxpayer may have qualified for abatement of penalties in one period of an audit and be subject to the 200% Sanction in another.

> **Example:** A taxpayer filed monthly ST-1-X returns during the Amnesty Program Period and paid $10,000 per month for the periods from January 2007 through December 2008. In March 2011, an auditor determined they actually owed $8,000 per month for January – December 2007 and $11,000 per month for January – December 2008. Since the full Eligible Liability was paid for each month in 2007, these months maintain the abatement of penalties and interest even if the taxpayer refused to sign the audit return reporting the additional $1,000 per month for 2008.

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The additional $1,000 per month for 2008 was subject to double penalties and interest. If the taxpayer did not sign the audit return and/or pay the full amount of Additional tax, penalties, and interest within 30 days, the taxpayer would also be subject to the 200% Sanction on the original $10,000 payments for 2008.

Although each period must be evaluated separately, auditors should not have prepared special returns to allow taxpayers to selectively agree to additional liabilities on a period by period basis.

14. TAXPAYERS NOT SUBJECT TO THE 200% SANCTION

The 200% Sanction did not apply to the following:

1) A taxpayer with an income tax liability that results from a Federal Change, if the Federal Change was not final as of the end of the Amnesty Program Period.

2) A taxpayer in bankruptcy proceedings during the Amnesty Program Period.

3) A taxpayer who, during the Amnesty Program Period, was a party to any civil litigation pending in an Illinois circuit court or Illinois appellate court or the Illinois Supreme Court. Ref: 86 Ill. Admin. Code § 520.101(b)(1) for 1 through 3 above.

4) A taxpayer who, during the Amnesty Program Period, was a party to any criminal investigation for nonpayment, delinquency or fraud in relation to any State tax imposed by any law of the State of Illinois with respect to an otherwise Eligible Liability.

5) A taxpayer who, prior to the beginning of the Amnesty Period, entered into an installment payment agreement with the Department. If the taxpayer fails to fulfill the terms of that agreement, they will be subject to the 200% Sanction.

6) A taxpayer under audit who, before the end of the Amnesty Program Period, submitted a request for an installment agreement, and the agreement was ultimately approved by the Collections Bureau. If the taxpayer fails to meet the terms of the agreement (defaults), the Collections Bureau will reinstate the 200% Sanction (see section on “Payment Plans”).

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15. INELIGIBLE TAXPAYERS

Taxpayers that were a party to any criminal investigation, or civil or criminal litigation that was pending in any Illinois circuit court, Illinois appellate court, or the Illinois Supreme Court during the Amnesty Program Period were not eligible. Ref: 86 Ill. Admin. Code § 520.105(d). Since these taxpayers were ineligible to participate in the Amnesty Program with respect to these liabilities, they are not subject to the 200% Sanction.

If taxpayers with civil cases pending in Illinois courts wished to participate in Amnesty, they were required to stipulate to judgment in favor of the Department and make full payment of tax during the Amnesty Program Period. If they did not, they were ineligible to participate in the Amnesty Program with respect to these liabilities, and they are not subject to the 200% Sanction.

Amnesty participation was not allowed for taxpayers who owed penalty and interest only. This occurred when a taxpayer had paid all of the tax liability due for a period, but had not yet paid all of the penalty and/or interest related to this liability.

16. PAYMENTS, OFFSETS, AND CREDITS

a) Method of Payment

Payments under the Amnesty program were allowed to be made by cash, check, money order, guaranteed remittance, or ACH debit. Payments of amounts due under the IITA (applies to individuals only) could be made by credit card, provided that the taxpayer paid any discount fee charged by the credit card issuer.

If ACH debit (WebPay option through the Department's website) was used by the taxpayer for Amnesty payments, the auditor should have followed the procedure in place pertaining to "Electronic Funds Transfer" to insure that the "Amnesty payment" was applied correctly to the proper APE (income tax) or audit period (sales tax). Refer to the "Electronic Funds Transfer" section of Chapter 20 for this procedure.

Verified overpayments and credit memorandums relating to sales and excise taxes could also be used to pay an Eligible Liability. To use these credits, taxpayers were required to provide a request to use them with the appropriate return. For information on using

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Manufacturer's Purchase Credit (MPC), see the section "Use of Manufacturer's Purchase Credit (MPC)".

Established tax liabilities could be paid by several methods:

- Electronically through the Department's web site at **tax.illinois.gov.**
- Using a credit card for Individual income tax liabilities.
- Mailing the payment, along with the provided payment voucher.
- Paying in person with checks or guaranteed remittances at any Illinois Department of Revenue office.
- Paying in person with cash at the JRTC building in Chicago or the Willard Ice Building in Springfield.

Eligible liabilities that were **not** Established Liabilities could be paid by three methods:

- Mailing the payment, along with any required original or amended return, to the PO Box address provided on the Amnesty letter.
- Paying in person with checks or guaranteed remittances at any Illinois Department of Revenue office. Appropriate original or amended returns were required.
- Paying in person with cash at the JRTC building in Chicago or the Willard Ice Building in Springfield. Appropriate original or amended returns were required.

(1) Payment Plans

Payment plans could be requested by taxpayers who received Amnesty letters. These taxpayers were required to submit a completed CPP-1, Payment Installment Plan Request, postmarked between October 1 and November 8, 2010, and have the Collections Bureau approve the request.

Since no special payment plan was established for Amnesty, all payment plans function as normal. Plans include tax, penalty and interest when set up and approved by Collections.

In order to qualify for Amnesty, the taxpayer was required to pay the full amount of the tax due during the Amnesty Program Period, so entering into a payment plan did not result in abatement of penalties and interest. However, taxpayers who established a payment plan before the end of

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the Amnesty Program Period were not subject to the doubling of penalty and interest if all payments were made as agreed. If a taxpayer later defaulted on their payment plan, all penalties and interest would double.

In order to qualify for a payment plan, the taxpayer must have filed all required returns from 2004 to the time they submitted the CPP-1. After October 15, 2010, the taxpayer also had to have a 2009 Individual Income Tax Return on file to be considered current.

Taxpayers who were establishing a payment plan for Individual Income Tax could request up to 60 months to pay off the outstanding balance.

Taxpayers who were establishing a payment plan for Business Income Tax could request a payment plan up to 24 months to pay off the outstanding balance.

(2) Taxpayers under Audit

Taxpayers under audit~~s~~, which could not be completed before the end of the Amnesty Program Period, were required to submit signed original or amended returns with payment~~s~~ for each applicable tax period in order to qualify for Amnesty. If taxpayers sent a payment without a return, the auditor was required to contact them and request that they file the required returns. If they refused, the auditor was required to document the refusal in their EDC-5. Double penalties and interest would apply to these payments.

Returns and payments for all tax types were requested to be mailed to:

Illinois Department of Revenue
Audit Bureau
PO Box 19012
Springfield, IL 62794-9012

All returns were scanned into the Audit Springboard-Attachments panel in Gentax, but not processed. The auditor's comments needed to state that estimated returns were received and are attached on the Audit Springboard. **ROT auditors** would use these estimated returns to make

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adjustments on the final EDA-105 (or equivalent) audit returns. For **Income tax auditors**, amended returns would be processed using the amounts shown on an original return filed during amnesty or the amounts in Column C of an amended return as the starting point for the audit adjustments. Note: Column C of the IL-1120X could only be used if Column A matched Gentax.

(3) NSF (non-sufficient funds) Checks

Payments by check that were returned due to insufficient funds (NSF) in the taxpayer's account did not qualify as payments during the Amnesty Program Period. If the money was not repaid within the Amnesty period, double penalties and interest applied.

b) Amnesty and Offsets

During the Amnesty Program Period, underpayments could be offset with overpayments from audit periods within the audit track. Ref: 86 Ill. Admin. Code § 520.105(c)(4)(ii). If the overpayment was established during an audit within the Amnesty Program Period, no interest would be payable by the Department on the portion of overpayment used to offset the underpayment. Interest would be paid only on the **net** overpayment. However, interest would be allowed on any refund or credit based on a refund claim that was outstanding as of the **beginning** of the Amnesty Program Period. Ref: 86 Ill. Admin. Code § 520.105(k)(5).

Example:
During the Amnesty Program Period, the auditor determined that the taxpayer overpaid January 2008 by $3,000. The auditor also determined that the taxpayer owed an additional $2,000 in January 2007 and an additional $1,500 in February 2009. The $3,000 overpayment was applied to the underpaid periods when the auditor prepared the EDA-105-R. Interest was only calculated on the $500 in tax from February 2009 that was not offset with the credit from January 2008. There was no overpayment interest granted for January 2008. Since the underpayments were discovered during an audit, penalties were calculated at the 15% rate for January 2007 and February 2009. The tax due was the difference between the overpaid and underpaid periods. As long as the taxpayer signed the EDA-105-R during the

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Amnesty Program Period, the $300 penalty on the $2,000 liability from January 2007 was abated. The $225 penalty for February 2009 was also eligible for abatement if the taxpayer paid the remaining $500 tax liability during the Amnesty Program Period.

Example:
During the Amnesty Program Period, a taxpayer was being audited for the 2007 and 2008 tax years. The taxpayer's 2007 original return had been "math errored" by the Department resulting in a balance due of $792,000. However during the audit, the auditor obtained the NLD schedule which allowed the reversal of the math error and resulted in the taxpayer having an overpayment of $300,000 for 2007. No other audit adjustments applied to 2007. For the 2008 tax year, audit adjustments resulted in the taxpayer having a proposed liability of $500,000. The $300,000 overpayment for 2007 was used to offset the $500,000 underpayment for 2008. The taxpayer needed to pay the $200,000 net liability during the Amnesty Program Period in order to qualify for the abatement of penalties and interest under amnesty.

If the audit resulted in a net overpayment, either a refund or credit memo was issued. Interest was earned only on the net overpayment. The auditor should have informed the taxpayer that they would not receive any interest on the portion of the overpayment used to offset the underpayment.

Example:
During the Amnesty Program Period, the auditor determined that the taxpayer under audit had overpaid the 2007 tax year by $5,000, but had underpaid the 2008 tax year by $3,500. Both years were included in the audit track. $3,500 of the 2007 overpayment was applied to the underpaid 2008 tax liability. Penalties and interest were abated for 2008. **The offset is an Amnesty payment in the underpaid period** (see 86 Ill. Admin. Code § 520.105(c)(4)(A)(ii)). Interest was only paid on the $1,500 net overpayment from the 2007 tax year.

If an audit could not be completed before the end of the Amnesty Program Period, the taxpayer was required to file and pay original or amended returns reporting the Eligible Liability and the overpayment periods used to offset that liability.

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After the Amnesty Program Period, taxpayers under audit were still able to offset liabilities with payments made during the Amnesty Program Period, but the offset occurred after the assessment of the 200% Sanction on any underpaid tax liability. Any excess payments for the audit would be credited or refunded to the taxpayer. There was no interest payable on any refund or credit that resulted from an overpayment of an Amnesty payment (see UPIA § 3-2(h)).

Example:
During the Amnesty Program Period, a taxpayer filed amended returns and paid an additional $3,000 for January 2007, an additional $10,000 for January 2008, and an additional $8,000 for February 2009. The Department initiated an audit **after** the Amnesty Program Period. The auditor determined that the taxpayer overpaid its January 2008 estimated amnesty payment by $3,000. The auditor also determined that the taxpayer owes an additional $2,000 in January 2007 and an additional$1,500 in February 2009. The $3,000 overpayment would be applied to the underpaid periods when the auditor prepared the EDA-105-R.

Penalties would be calculated at the doubled 30% rate on the $2,000 for January 2007 and $1,500 for February 2009 and the tax due would be the difference between the overpaid and underpaid periods. The EDA-105-R would list tax of $500 ($2,000 + $1,500 - $3,000) and penalties of $1,050 (($2,000 + $1,500) x 30%). Interest would be computed on the $3,500 underpayment at double rates. These penalties and interest would not be reduced even if the taxpayer paid the full amount of additional liability. If the taxpayer did not pay the full amount of the additional liability prior to the due date of any demand for payment issued by the Department, the abatement of penalties and interest would be forfeited and the 200% Sanction applied to the Amnesty payments of $3,000 for January 2007 and $8,000 for February 2009.

For **Income Taxes**, the auditor could do an offset if it was between years within the audit period. **No pending income tax refunds were allowed to be offset <u>during</u> the amnesty program period.**

Example:
A taxpayer was under an income tax audit for tax years 2007 and 2008 **after** the Amnesty period. The taxpayer had filed and paid amended returns estimating the tax liability for both years during the Amnesty Program Period. The auditor determined that the taxpayer overpaid the 2007 estimated tax liability by $2,000 but has underpaid the 2008 by $1,000. The taxpayer currently had a

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pending refund of $500 from the 2006 tax year which could not have been used to offset any underpayment during the Amnesty Program Period, because 2006 was not in the audit (see Regulation § 520.105(c)(5)). The $2,000 overpayment from 2007 could be used to offset the underpaid $1,000 for 2008; however, the 200% Sanction would be calculated on the $1,000 underpayment for 2008 before any offset of the overpayment. Any overpayment amount that remained after offset would be credited or refunded to the taxpayer.

If a pending refund for a given year was reduced by an audit, the auditor should have shown the adjustment on the IL-870 and then put a note in the comments that the adjustment merely reduced the pending refund. No penalty or interest should have been imposed, except in the case where the refund was the result of a carryback, so that restricted interest would apply to the adjustment. An email should have been sent to the Audit Perfection and Review supervisor requesting that an audit indicator be placed on the account to ensure that the refund was not made before the audit was processed.

c) Cash Prepayments (Sales Tax Only)

Cash prepayments (applied to Sales Tax only) made prior to the Amnesty Program Period could be used to qualify for Amnesty even if there was no other liability paid during the Amnesty Program Period.

Example:
A taxpayer was under audit for January 2007 – June 2009. After receiving an audit initiation letter in September 2009, a prepayment was made against the audit of $100,000. The auditor completed the audit on October 15, 2010, and determined that the additional liability was $90,000. The taxpayer could qualify for abatement of penalties and interest by signing the audit return and requesting that $90,000 of the prepayment be applied to the audit Amnesty liability. The remaining $10,000 was applied to post-Amnesty periods. If the post-Amnesty liability was less than the $10,000, the taxpayer received a credit memorandum or refund for the difference. Since the remaining $10,000 was not applied to an Amnesty period, it was eligible for interest.

Cash prepayments which were not included on a return filed before the end of the Amnesty Program Period did not qualify as amnesty payments.

Example:

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A taxpayer was under audit for January 2007 – June 2009. After receiving an audit initiation letter in September 2009, a prepayment was made against the audit of $100,000. The auditor completed the audit on October 15, 2010 and determined that the additional liability was $125,000. The taxpayer did not agree to the full liability, did not file amended returns, and did not pay the remaining $25,000. Since the $100,000 prepayment was not reported on a return prior to the end of the Amnesty Program Period, the entire $125,000 liability was subject to the 200% Sanction. The $100,000 prepayment was applied to the audit liability after the 200% Sanction was applied to Amnesty periods.

d) Use of Manufacturer's Purchase Credit (MPC)

The reduction of a liability that results from the use of Manufacturer's Purchase Credit is not a payment of tax. Therefore, the use of MPC did not qualify a taxpayer for Amnesty. The taxpayer could, however, use MPC to offset the amount of use tax due on production related tangible personal property. Penalty and interest applied to this liability, but if the taxpayer paid the remaining audit liability during Amnesty, these were abated.

Example #1:
A taxpayer had a $100,000 use tax liability. $40,000 was tax on production related tangible personal property. The taxpayer paid the $40,000 with available MPC when the audit was completed on October 15, 2010, and the taxpayer did not contest the results and paid the remaining $60,000 liability during the Amnesty Program Period. All penalties and interest were abated on the entire $100,000 liability.

Example #2:
The taxpayer had $40,000 in unpaid production related use tax liability, and the taxpayer authorized the use of $40,000 of available MPC to pay the liability. The taxpayer did not qualify for Amnesty because no tax liability which could qualify the taxpayer for Amnesty was unpaid. The taxpayer owes the penalty and interest even if the MPC was used during the Amnesty Program Period. Since the taxpayer had an Eligible Liability that was not paid during the Amnesty Program Period the penalties and interest will double.

Example #3:
The taxpayer had $40,000 in production related use tax liability, but no other tax liability and the taxpayer authorized the use of $15,000

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of available MPC to pay part of the tax liability. The taxpayer could qualify for Amnesty by paying the remaining $25,000 during the Amnesty Program Period and all penalties and interest would be abated.

Example #4:
A taxpayer had a $100,000 use tax liability. $40,000 was tax on production related tangible personal property. The taxpayer signed the audit return and paid the $40,000 with available MPC when the audit was completed on October 15, 2010, but the taxpayer did not pay the remaining $60,000 liability by the end of the Amnesty Program Period. Penalties and interest will double on the entire $100,000 liability.

Example #5:
A taxpayer was under audit during the Amnesty period but the audit could not be completed by November 8, 2010. An additional use tax liability was estimated at $50,000 of which $40,000 was production related. The taxpayer made an amnesty payment of $10,000 and completed an MPC-1 directing the Department to pay the remaining $40,000 with available MPC. After the Amnesty period, the auditor determined that the additional liability was $60,000 of which $50,000 was production related. The remaining $10,000 liability is subject to the 200% Sanction regardless of whether a cash payment was made or MPC was used.

Example #6:
A taxpayer was under audit during the Amnesty period that could not be completed by November 8, 2010. An additional use tax liability was estimated at $50,000 of which $40,000 was production related. The taxpayer made an Amnesty payment of $10,000 and completed an MPC-1 directing the Department to pay the remaining $40,000 with available MPC. After the Amnesty period, the auditor determined that the additional liability was $30,000, of which $20,000 was production related. No additional liability is due. All penalties and interest will be abated, and the taxpayer will be able to add the $20,000 in excess claimed MPC to its available MPC balance.

Example #7:
A taxpayer was under audit during the Amnesty period that could not be completed by November 8, 2010. An additional liability was estimated at $50,000 of which $40,000 was production related. The taxpayer made an Amnesty payment of $10,000 and completed an

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MPC-1 directing the Department to pay the remaining $40,000 with available MPC. After the Amnesty period, the auditor determined that the actual additional liability was $35,000, of which, $5,000 was production related. After taking into account the $10,000 Amnesty payment and the $5,000 in production related supplies, the additional liability is $20,000 and is subject to the 200% Sanction. The taxpayer will be able to add the $35,000 in excess claimed MPC to its available MPC balance.

Example #8:
A taxpayer did not make an Amnesty payment and is selected for audit after the Amnesty period. The auditor determines that the additional liability is $30,000, of which, $5,000 is production related. All of the additional liability is subject to the 200% Sanction regardless of whether the additional liability is paid in cash or with MPC.

Example #9:
A taxpayer made a $5,000 Amnesty payment and is selected for audit after the Amnesty period. The auditor determines that the additional use tax liability is $30,000, of which, $5,000 is production related. All of the additional liability is subject to the 200% Sanction regardless of whether a cash payment is made or MPC is used. If the taxpayer contest the audit or do not pay the additional tax due by the due date shown on the assessment, the original $5,000 Amnesty payment is also subject to the 200% Sanction.

If an audit could not be closed by the end of the Amnesty Program Period, taxpayers needed to list the MPC amount they wanted to use on the ST-1 return for each applicable period. They also were asked to complete an MPC-1 to report the amount of MPC they wished to apply to satisfy their Amnesty liability. Failure to provide the MPC-1, however, would not invalidate their amnesty status if they otherwise qualified.

MPC for Credit Swaps

Participating in Amnesty did not prevent a taxpayer from exchanging MPC for credit on production related liabilities. This was not considered contesting an amnesty liability, but rather a payment exchange which did not affect the taxpayer's liability for the period.

Example:

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A taxpayer signs an audit return and makes a $5,000 Amnesty payment on Use Tax liability due for May 2009 during the Amnesty Program Period in order to qualify for abatement of penalties and interest. In January 2010, the taxpayer files an EDA-98 requesting to exchange $5,000 in available MPC for credit. Whether or not the auditor approves the exchange, the taxpayer will not lose the original abatement of penalties and interest.

e) Loss Carryovers or Credits

If an audit could not be closed by the end of the Amnesty Program Period, the taxpayer needed to file an amended return indicating the amount of losses or credits that were available for use in the tax period. Reduction of the tax liability to zero using those losses or credits did not qualify as an Amnesty payment per 86 Ill. Admin. Code § 520.105(c)(1). However, if the reduction was the result of a carryforward, the interest and penalties associated with the reduction were eliminated. A carryback, on the other hand, could reduce the liability to zero, without eliminating penalty and interest, so that the taxpayer still owed the penalty and interest and had no liability it could pay during Amnesty to abate these amounts.

Example 1: A taxpayer filed an amended 2008 income tax return claiming $1,000 in enterprise zone investment credits that were earned in 2007 and carried forward to 2008. This $1,000 credit reduced the tax liability to zero, and eliminated any late payment penalty and interest arising from the taxpayer's failure to timely pay any of the original 2008 liability.

Example 2: A taxpayer filed an amended 2008 income tax return reporting an additional $1,100 in tax and claiming $1,000 in enterprise zone investment credits that were earned in 2007 and carried forward to 2008. During the Amnesty Program Period, taxpayer also paid the $100 liability remaining after using the credit. As a result, the taxpayer qualified for Amnesty and was entitled to penalty & interest abatement on its 2008 underpayment.

Example 3: A taxpayer timely filed and paid the 2005 income tax return showing a tax liability of $100. Taxpayer was a non-filer for 2003 and 2004 tax years. During the Amnesty Program Period the taxpayer filed a 2003 original

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return showing an Illinois net loss of $1,000, a 2004 original return showing an Illinois net loss of $800, a 2005 amended return showing $2,000 in additional income before net loss deductions. The 2003 and 2004 Illinois net loss amounts must be carried forward to the 2005 tax year. Because the 2003 and 2004 net loss carryforwards did not entirely offset the increase in 2005 net income, the taxpayer could participate in the amnesty program. Note also that, because the taxpayer had no 2003 or 2004 tax liability, it could not participate in the amnesty program for either of those years.

Restricted Interest on Capital Loss Carrybacks

"Restricted interest" is a federal income tax term which refers to interest that accrues on an underpayment between the date it arises and the date it is reduced or eliminated by a carryback. For more information about restricted interest, see Audit Manual Chapter 31 (new chapter 42).

Restricted interest can also be "assessed" in a field audit situation, where the IDOR auditor has established an additional tax liability and then offset, either a portion, or the total additional liability, with an Illinois NLD carry back (for years prior to 12/31/03).

Under the Amnesty program, if the total additional tax liability was satisfied by means of an Amnesty payment, as well as an offset from an Illinois net operating loss deduction that restricted interest assessment would be abated. However, under the 2010 Amnesty Program, if a federal capital loss (or net operating loss or Illinois net loss) reduced the tax liability to zero, there would be no Eligible Liability to pay under Amnesty per 86 Ill. Admin Code § 520.105(c)(1). In a situation where the INLD eliminated the entire tax liability, restricted interest would not be abated as this would not be considered a "payment" under Amnesty.

17. AUDIT ISSUES

Audits Completed Prior to, During, and After Amnesty

a If an audit was completed **prior to the beginning** of the Amnesty Program Period, the taxpayer could participate in Amnesty by signing the EDA-105 and paying the tax amount reported on that EDA-105, or by paying the tax amount reported on the IL-870. However, the payment was required to be made during the Amnesty Program Period of October 1 through

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November 8, 2010, for the taxpayer to qualify for penalty and interest abatement.

b If the audit was **completed during the Amnesty Payment Period,** and the taxpayer wanted to pay, the auditor needed to obtain signed EDA-105's (for Sales Tax) and payment for the full tax liability. A signed IL-870 was not required with the full tax payment for Income Tax.

c If an audit **could not be completed before the Amnesty period expired,** the taxpayer could still participate in Amnesty. The taxpayer needed to make a reasonable estimate of the tax liability and submit an original or amended return with payment for that liability during the Amnesty payment period. The return with payment was to be sent to the audit PO Box listed on the taxpayer's Amnesty notification letter, or could be given to their auditor for submission. The taxpayer was required to make their "best estimate" of the tax liability.

If the estimate was less than the final liability, the taxpayer would be subject to the 200% Sanction only on the additional amount that was not paid as long as they paid the remaining amount by the due date shown on the demand for payment. Issuance of the IL-870 or EDA-105 was notice and demand for payment. [Note: The EDA-105 and IL-870 are no longer viewed as a notice and demand, but were considered as such during Amnesty.] If the estimate was less than the final liability and the taxpayer did not pay the additional amount by the due date, they would be subject to the 200% Sanction on both the Amnesty payment and the additional liability.

Example: Since an audit could not be completed before November 8, 2010, a taxpayer estimated their 2007 income tax liability to be $4,000 and submitted an amended return with payment. In December 2010, the auditor determined that an additional $1,000 of tax liability was due. If the taxpayer paid the additional $1,000 tax, plus the double penalty and interest on the $1,000, within 30 days of the interest through date listed on the audit return, penalties and interest would be abated on the $4,000 paid during Amnesty.

If the taxpayer failed to pay the additional tax, penalties, and interest by the due date, double interest and penalty would apply to both the Amnesty payment and the additional liability (all $5,000).

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If the Amnesty payment resulted in an overpayment, the taxpayer could have used the overpayment to satisfy a liability for a separate period within the audit. However, the offset would occur after penalties and interest were applied to the underpaid liability, including the 200% Sanction, if the other period qualified for Amnesty.

Example 1: A taxpayer under audit estimated owing an additional $1,000 each for January 2009, March 2009, and June 2009. The taxpayer submitted ST-1-Xs along with payment to their auditor during the Amnesty Program Period. In January 2011, the auditor determined that the taxpayer did not owe the additional $1,000 for January 2009, but did owe $1,000 for February 2009 in addition to the $1,000 paid in the Amnesty Program Period. The taxpayer could use the January 2009 overpayment to offset the February 2009 tax liability, but since February 2009 is an Amnesty period, the taxpayer would owe double penalties and interest prior to the offset. The auditor presented a bill for $0 in additional liability, $300 in doubled penalties, and doubled interest.

Example 2: A taxpayer under an income tax audit estimated owing an additional $500 tax liability for each of the years 2007 and 2008. The taxpayer submitted amended returns with $500 payments for both years during the Amnesty Program Period. In late December 2010, the auditor determined that the taxpayer did not owe the $500 for 2007, but the taxpayer owed a total of $800 ($300 underpaid) for 2008. The taxpayer could use the $500 overpayment from 2007 to offset the additional $300 liability for 2008, but the taxpayer would owe the double penalties and interest on the $300 underpayment for 2008. If the 2007 overpayment exceeds the 2008 deficiency, penalties and interest, the remainder will be refunded (but no interest will apply).

18. AMNESTY AND NON-AMNESTY PERIODS

If an audit covers periods that are outside of the Amnesty periods, the auditor should have done the following:

For income tax, both the Amnesty and non-Amnesty periods could be kept in the same track and be included on the same IL-870. Since each year is processed on its own EDA-25 for income tax, the penalties and

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interest would be abated on the EDA-25's for the Amnesty years and would not be abated on the EDA-25 for the post-Amnesty year.

For sales tax, the audit could remain in one track, but it needed to be reported on at least two EDA-105s, one EDA-105 for the Amnesty periods, and a second one for the non-Amnesty periods. As with non-Amnesty audits, if the taxpayer did not agree to or pay the additional liability, additional returns needed to be prepared for each liability period that was less than one year from the interest through date listed on the audit returns.

19. AMNESTY AND ADMINISTRATIVE HEARINGS

Taxpayers that were in Administrative Hearings were eligible to participate in the Amnesty Program. To participate in Amnesty taxpayers needed to stipulate to judgment in favor of the Department concerning that liability on or before November 8, 2010, and pay that liability during the Amnesty Program Period.
The filing of a return or amended return was not required by taxpayers in regard to the liability that was the subject of the proceeding, but taxpayers were required to stipulate that they were participating in Amnesty and to pay during the Amnesty period.

Failure to participate in the Amnesty Program concerning the liability that was the subject of the proceeding subjected taxpayers to the 200% Sanction of double penalty and interest.

Taxpayers can go to Administrative Hearings on unagreed issues which they paid under Amnesty. If a taxpayer contests an additional tax liability and loses, or pays the additional liability and later files an unsuccessful claim for refund against that liability, they will lose the benefit of Amnesty on the entire liability paid during the Amnesty Program Period. Ref: 86 Ill. Admin. Code § 520.105(j)(4)(B).

For income tax, if the taxpayer had an unagreed issue for only one year, and only agreed issues for other years of the audit period, the taxpayer could participate in Amnesty for the agreed years, and go to Administrative Hearings on the unagreed year without affecting its Amnesty for the agreed years.

For sales taxes, if a taxpayer had an unagreed issue in only one month and only agreed issues in the remaining months, the taxpayer could go to Administrative Hearings on the unagreed period and participate in Amnesty by filing returns and paying the liability on the agreed periods.

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20. AMNESTY AND COURT

Amnesty could not be granted to a taxpayer that was a party to any civil litigation that was pending in any Illinois circuit court, Illinois appellate court, or the Illinois Supreme Court. If such taxpayers wanted to participate in Amnesty, they needed to have the civil action dismissed by executing an agreed order stipulating to judgment in favor of the Department and by paying that liability during the Amnesty Program Period.

Taxpayers did not need to file an original or amended return concerning the liability that was the subject of the litigation, but they did need to specify, in the motion to dismiss the action, that it was being done in order to participate in Amnesty. The liability payment needed to be accompanied by a statement that the payment was intended to qualify the taxpayer for Amnesty and must have identified the liability being paid.

Any taxpayer who was not eligible to participate in Amnesty for being a party to a civil action is not subject to the 200% Sanction on that liability for failure to participate in the Amnesty Program.

A taxpayer in bankruptcy was eligible to participate in Amnesty since bankruptcy proceedings take place in federal court. Ref: 86 Ill. Admin. Code § 520.105(d)(3). However, the taxpayer would have had to receive permission from the federal court in order to participate in Amnesty. The inability of a taxpayer to obtain this permission from the federal courts shall constitute reasonable cause for not participating in Amnesty. Ref: 86 Ill. Admin. Code § 520.105(m)(3). The 200% Sanction does not apply to a taxpayer in bankruptcy proceedings during the Amnesty Program Period. Ref: 86 Ill. Admin. Code § 520.101(b)(1)(B).

Taxpayers could go to court on unagreed issues which they paid under Amnesty. If a taxpayer contested an additional tax liability and lost, or paid the additional liability and later filed an unsuccessful claim against that liability, they would lose the benefit of Amnesty on the entire liability paid during the Amnesty Program Period. Ref: 86 Ill. Admin. Code § 520.105(j)(4)(B).

21. AMNESTY AND ICB

The Informal Conference Board (ICB) process is technically part of an ongoing audit. ICB case decisions are not considered legal settlements. Therefore, taxpayers who were in ICB or those who petitioned for a review before ICB on an incomplete audit were eligible for Amnesty. Such

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taxpayers had options pertaining to Amnesty participation. These options were:

- The taxpayer could withdraw from ICB by agreeing with the audit paperwork as filed and paying this audit liability amount under Amnesty.
    - If, during the Amnesty payment period, the taxpayer paid the full amount of the additional tax liability, and ICB later reduced the amount, the taxpayer would receive a credit or refund, whichever would be applicable for the overpayment.
- If Amnesty was going to expire before the audit was complete, the taxpayer could make their "best estimate" of the tax liability, submit the applicable original or amended returns with payment, and still request that ICB review the audit.

If ICB upholds the audit results, and an additional amount is owed that was not paid during Amnesty, the taxpayer would owe double penalties and interest only on the additional amount not paid under Amnesty as long as the taxpayer signs the return and pays the additional liability within 30 days of being presented the EDA-105 or IL-870 results.

22. UNDERPAYMENT OF AMNESTY AUDIT LIABILITY

Failure to pay an Eligible Liability in full would invalidate the Amnesty provision granting abatement of penalties and interest. If a taxpayer did not pay the entire Eligible Liability for that tax period, the 200% Sanction would apply for failure to comply under Amnesty. Ref: 86 Ill. Admin. Code §§ 520.101(b)(4) and 520.105(h) & (i).

The following examples are illustrative:

For income tax, assume that the audit covered three years and the first two were paid in full during the Amnesty payment period. The Auditor's Reports for the first two years would be processed with no penalties and interest since they were paid in full. Since the taxpayer did not pay the third year in full, the taxpayer would have double penalties and interest on this liability.

For sales tax, the doubling or abatement of penalties and interest is calculated using the Schedule 2a for interest and Schedule 2b for penalties. Audit returns reflecting these amounts must be prepared

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for each UPIA period and for post amnesty periods. The taxpayer may agree to additional audit liability on a return by return basis, but not a period by period basis. Failure to sign one return will not cause a taxpayer to lose their amnesty status on the periods listed on another return as long as all the amnesty requirements are met for that return.

23. UNAGREED AUDIT ISSUES

A taxpayer could participate in Amnesty selectively, provided that the taxpayer completely satisfied its Eligible Liability for the tax type and tax period for which Amnesty had been sought. However, an issue-by-issue basis for an eligible year/period was not allowed under the Amnesty program. The taxpayer needed to pay the entire tax liability for each year/period to qualify for abated penalties and interest. Ref: 86 Ill. Admin. Code § 520.105(b)(1)(A) & (B).

For income tax, this means that if a taxpayer owed $10,000 in tax on 2008 at the end of the audit, the taxpayer needed to pay the entire $10,000 tax during the Amnesty Program Period to have the penalties and interest waived on that year. The taxpayer could not take an unagreed issue of $2,000 for 2008 to Administrative Hearings or to Court and still have Amnesty on the remaining $8,000. However, if the taxpayer had only an unagreed issue attributable to one year, and agreed issues attributable to other years of the audit period, the taxpayer could take Amnesty for the agreed years, and go to court on the unagreed year.

For sales taxes, if a taxpayer had only an unagreed issue in one month and agreed issues in the remaining months, the taxpayer could go to Administrative Hearings or court on the unagreed period and participate in Amnesty by paying the liability on the agreed periods. However, if there were unagreed issues as well as agreed issues in the same tax period/month, the taxpayer could not separate the agreed issues from the unagreed issues; the taxpayer needed to pay the entire liability in order to get the benefits of Amnesty.

24. CLAIMS FOR REFUND (OR CREDIT) – GENERAL

No **interest** was paid by the Department on any refund allowed for overpayments made under Amnesty. Ref: UPIA § 3-2(h) and 86 Ill. Admin. Code § 520.105(k)(4) & (5).

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a) Established Liabilities

Claims against Established Liabilities were only allowable if they were based on "issues unrelated to the issues for which the taxpayer claimed Amnesty" or if they were due to a federal change (RAR) finalized after the Amnesty Program Period. Ref: 86 Ill. Admin. Code § 520.105(k).

> **Example:** A taxpayer paid a previously assessed liability of $100,000 for January 2007 during the Amnesty Program Period and had all penalties and interest abated. In February of 2011, the taxpayer filed a claim against the audit for $100,000 based on a related issue. The claim would be disallowed regardless of the merits of the issue since no refund is allowed with respect to an Amnesty issue. Ref: 86 Ill. Admin. Code § 520.105(f)(1).

"Issues unrelated to the issues for which the taxpayer claimed Amnesty" are issues related to facts that were unavailable at the time the Amnesty payment was made. The following are examples of unrelated issues which would allow a taxpayer to file a claim against an Amnesty payment made on an Established Liability:

i. After the Amnesty period, a customer presents a new resale certificate, "E" letter, ST-587, or similar valid exemption declaration to a taxpayer for a sale during a period on which the taxpayer has already made an Amnesty payment.

ii. A customer returns an item purchased during a period on which the taxpayer has already made an Amnesty payment.

iii. The taxpayer receives a Schedule K-1-P from a partnership in 2011 showing that the taxpayer was entitled to a credit for an Amnesty year (2008), and this credit had not been previously reported to the taxpayer.

iv. A math error, such as a transposition of figures, occurred in the preparation of the Amnesty return.

v. An overpayment that results from the taxpayer's failure to take into account collection activity by the Department such as an offset of an overpayment of a different tax.

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vi. An overpayment that results from the taxpayer paying the liability shown on a bill, where the bill did not take into account a payment made prior to Amnesty by the taxpayer.

The following are examples of amnesty issues on which taxpayers may not file a claim against an Established Liability Amnesty payment:

i. A customer informs the taxpayer that they overcollected tax on a transaction for sales tax.

ii. A taxpayer discovers that they had a valid resale certificate in their possession prior to making the Amnesty payment.

iii. A tax auditor from another state informs the taxpayer that they incorrectly paid tax to Illinois on an item that was shipped outside the state.

iv. A taxpayer understates a subtraction modification for bonus depreciation. The taxpayer knew of the bonus depreciation at the time of Amnesty.

Example: A taxpayer, on the 2008 Illinois income tax return, claimed $1,000 in enterprise zone investment credits that were earned in 2007 and carried forward to 2008, since the taxpayer had credits in excess of its 2007 liability. The taxpayer discovers that it had underpaid the 2008 Illinois income tax liability by $500 due to a sales factor computation error and pays this $500 (with an amended return) under the Amnesty Program. Later the taxpayer realizes that it failed to claim a subtraction for interest on federal obligations for 2007. This subtraction reduces the pre-credit liability by $200 thus increasing the allowable enterprise zone investment credit carryover to 2008 by $200. No refund for 2008 will be allowed, since the base income reduction for 2007 is based on facts that were in existence as of the time that the Amnesty payment was made.

b) Claims on Completed Audits

86 Ill. Admin. Code § 520.105(k)(3) limits claims against Eligible Liabilities paid under the Amnesty Program Period when the taxpayer was under audit during the Amnesty Program Period. To successfully file the claim, the taxpayer must have demonstrated that the claim was

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based on "issues unrelated to the issues for which the taxpayer claimed Amnesty" or due to a federal change finalized after the Amnesty Program Period.

Example 1: During the Amnesty Program Period, the taxpayer signs an IL-870 for 2007 and pays the listed $6,000,000 in eligible tax liability in order to qualify for abatement of all penalties and interest. In January 2011, the taxpayer files a claim against the audit liability for $3,000,000 based on an issue that the auditor had denied during the audit. Regardless of the merit of the claim, the auditor will deny it since this is not an unrelated issue.

Example 2: During the Amnesty Program Period, the taxpayer signs an IL-870 for 2007 and pays the listed $6,000,000 in tax liability in order to qualify for abatement of all penalties and interest. In January 2011, the taxpayer files a claim against the audit liability for $2,000,000 based on a federal change finalized in December 2010. The taxpayer is eligible for a refund of the $2,000,000, but does not receive interest on this refund. The amnesty status of the remaining $4,000,000 liability that was paid during the Amnesty Program Period is not affected.

c) Claims on Audits Completed After the Amnesty Program Period

A taxpayer who unsuccessfully files a claim against an additional Eligible Liability established after the Amnesty Program Period would be subject to the 200% Sanction on any liability paid during the Amnesty Program Period. REF: 86 Ill. Admin. Code § 520.105(j)(3)(B) and (j)(4)(B).

Example 1: Since its income tax audit cannot be completed before the end of the Amnesty Program Period, a taxpayer estimates its tax liability for 2007, files an amended return, and pays the estimated $10,000 on November 4, 2010. In January 2011, the audit is completed showing the taxpayer's liability for 2007 to be $12,000. The taxpayer agrees with the audit findings and pays the additional $2,000 liability plus the 200% Sanction on that additional liability.

The penalties and interest on the $10,000 paid during Amnesty are abated. In February 2011, the taxpayer files an unsuccessful

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claim against the audit for $1,000 which causes the abatement of penalties and interest to be forfeited on the $10,000 Amnesty payment.

Example 2: A sales tax audit cannot be completed before the end of the Amnesty Program Period. The taxpayer files an amended return during the Amnesty Program Period, and pays an estimated $100,000 in additional liability for January 2007. In January 2011, the taxpayer signs a return listing an additional liability of $110,000 for the audit periods (not including the Amnesty payment). The taxpayer pays the remaining $10,000 in tax plus the 200% sanction on that liability.

The penalties and interest on the $100,000 paid during Amnesty are abated. In February 2011, the taxpayer files a claim against the audit for $100,000. All but $6,000 of the claim is denied. Since the taxpayer unsuccessfully contested a portion of the $10,000 additional liability, it loses the Amnesty status on the payment made during the Amnesty Program Period (the original $100,000). The 200% sanction will now apply to the original Amnesty payment.

A taxpayer who unsuccessfully files a claim against an Eligible Liability which was paid in full during the Amnesty Program Period would not be subject to the 200% Sanction.

Example: A sales tax audit cannot be completed before the end of the Amnesty Program Period. The taxpayer files an amended return during the Amnesty Program Period, and pays an estimated $100,000 in additional liability for January 2007. In January 2011, the taxpayer signs an audit return listing a total liability of $90,000 and receives a $10,000 credit and abatement of penalties and interest. In February 2011, the taxpayer files a claim against the audit for $50,000. The claim is denied, regardless of the merits, because it was not allowed in the audit, but since they paid the full Eligible Liability during the Amnesty Program Period, they do not lose the abatement of penalties and interest.

Generally, **no interest** was payable by the Department on any refund or credit allowed for a tax and period for which the taxpayer participated in the Amnesty Program. A taxpayer was considered to have participated in Amnesty for a period even if they filed a return for a period in which an auditor later determined they had no liability

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eligible for Amnesty. The exception pertaining to interest was for claims filed prior to the start of the Amnesty Program Period. Interest would be allowed on any refund or credit based on a refund claim that was outstanding as of the beginning of the Amnesty Program Period. Ref: 86 Ill. Admin. Code § 520.105(k)(5).

d) Unsuccessful Claims against Amnesty Periods and the 5% Penalty

If a taxpayer unsuccessfully filed a claim against an audit in which the reduced 15% penalty rate was paid, the additional 5% penalty on the denied portion of the claim would have to be paid. How this applies to Amnesty related liabilities depends on the specific situation. Below is a list of potential amnesty scenarios and the ways they are addressed:

a Scenario 1

A taxpayer paid the full liability for a period prior to the start of the Amnesty Program Period and paid the reduced 15% audit penalty rate, then filed an unsuccessful claim against that period after the Amnesty Program Period.

Question: What is the appropriate penalty rate to charge for this period?

Response: If the taxpayer did not have an Eligible Liability which could be paid during the Amnesty Program Period, the taxpayer was neither eligible for abatement of previously paid penalties nor subject to the 200% sanction.

The claim would be treated the same as a non-amnesty audit. The taxpayer would owe an additional 5% on the denied portion of the claim.

b Scenario 2

A taxpayer paid the full Eligible Liability for a period during the Amnesty Program Period and received abatement of penalties. After the Amnesty Program Period, the taxpayer unsuccessfully filed a claim against that period.

Question: What is the appropriate penalty rate to charge for this period?

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Response: If the taxpayer paid the full Eligible Liability during the Amnesty Program Period and received abatement of penalties, the taxpayer would not be subject to the additional 5% penalty on the denied portion of the claim. The taxpayer met the terms of amnesty when paying the full eligible liability during the Amnesty Program Period. Filing an unsuccessful claim did not cause the loss of amnesty status because the taxpayer would still have paid the full Eligible Liability during the Amnesty Program Period.

c Scenario 3

A taxpayer filed a return and made an estimated amnesty payment for a period during the Amnesty Program Period which qualified for abatement. An audit was completed after the Amnesty Program Period and the taxpayer paid an additional tax liability which was subject to the doubled 30% penalty. The taxpayer then filed a claim against the period.

Question: What is the appropriate penalty rate to charge for this period if the claim is partially denied or denied in full?

Response: If the approved portion of the claim is greater than the additional liability (the amount that was paid after the Amnesty Program Period), the taxpayer owes no additional penalties. The revocation of the abatement of penalties only applies if the taxpayer had unsuccessfully contested the additional liability.

If the approved portion of the claim is less than the additional liability, the taxpayer loses the abatement of penalties on the payment made during the Amnesty Program Period. Under our guidelines for implementing the additional 5% penalty only on the denied portion of the claim, the applicable rate depends on the amount of the claim. Any denied portion of the claim would be subject to the doubled 40% penalty. Any unclaimed amount would be subject to the doubled 30% penalty.

25. FEDERAL AUDIT CHANGES

A taxpayer who participated in the Amnesty Program could **claim a refund for an overpayment** of an Estimated Federal Change Liability (Federal RAR). Estimated Federal Change Liability means the Eligible Liability that a taxpayer estimates will result from a Federal Change (RAR) that had not become final under IITA § 506(b) as of the end of the Amnesty Program Period. Amended returns could be filed to report finalized federal audit

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changes for Amnesty years, and refunds related to the finalized RAR changes could be requested for liabilities that were paid under the Amnesty program.

For situations where an RAR resulted in an increase to an INL that was carried into an Amnesty year, or for situations where an RAR resulted in reversing an income year to an INL that could be carried into an Amnesty year, refund claims on an Amnesty year would be permitted. However, the auditor had to verify that the amended return was only for the finalized RAR changes (or for the change in INL that resulted from the RAR changes.)

If a taxpayer paid an Estimated Federal Change Liability under Amnesty and the finalized Federal Change (RAR) adjustment increased the liability for that period, the Amnesty status would remain for the portion previously paid during Amnesty, if the taxpayer timely paid the full RAR liability. Additionally, the liability associated with the finalized RAR would be subject to standard penalties and interest, not the 200% Sanction.

However, if the taxpayer failed to timely pay the liability as required under IITA § 506(b), or to pay any interest and penalty on the additional liability when billed, the abatement of penalties and interest originally allowed under the Amnesty Program for that tax liability would be forfeited. Standard penalty and interest would apply to the total liability owed by the taxpayer for that eligible tax period, not the 200% Sanction.

> **Example:** During Amnesty, a taxpayer filed (with payment) an amended 2007 Illinois income tax return reporting an Estimated Federal Change Liability of $10,000. The finalized Federal Change showing an additional $1,000 liability is filed in 2011. If the taxpayer timely reports and pays the $1,000 under IITA § 506(b) and pays any related single interest and penalty by the due date on the Department's notice and demand, the interest and penalty will remain abated on the $10,000. However, if the taxpayer fails to timely report and pays the $1,000, or fails to pay any related interest or penalties by the due date on the bill, the Amnesty abated interest and penalty will be forfeited. Single interest and penalty would apply to the total $11,000.

If the IRS finalized an audit that increases tax in a year by less than the estimated federal change payment made under Amnesty, any overpaid Illinois Income Tax could be refunded for that year. However, per IITA § 911(a)(1), a refund claim must be filed within the latter of:

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1 **three years from the date the original return was filed for the taxable year,**

OR

2 **one year after the payment was made.**

If the Federal audit is finalized subsequent to both of the above stated dates, no refund would be allowed unless the taxpayer filed a timely claim for refund (protective claim), or the statute had been held open by a timely filed waiver (IL-872).

a) Refund Denied

The taxpayer filed an amended return on October 8, 2010, for the 12/31/2007 period with an amnesty payment of $1,500. The October 8, 2010 amended return estimated a pending RAR adjustment that had yet to be finalized. The taxpayer did not provide a Waiver (IL-872) with the October 8th amended return. The filing date of the original return occurred on 10/15/2008. On December 12, 2011, the taxpayer files another amended return reporting the RAR adjustments that were finalized on 12/4/2011. The December 12th amended return is claiming a $500 overpayment of the original $1,500 Amnesty payment. The following table illustrates the taxpayer's amended return filings:

Description (APE =12/31/2007):	Amount
Amended return # 1 – Amnesty return:	
Apportioned Illinois business Income (Per original return – as filed) (column A)	$7,850
Net Change reported- estimated RAR increase (column B)	$21,000
Apportioned Illinois business income (as corrected) (column C)	$28,850
Total tax paid- (per original return – as filed) (column A)	$492
Net change- Amnesty Payment	$1,508
Total tax paid- (as corrected) (column C)	$2,000
	Amount
Amended return # 2 – Reporting finalized RAR:	
Apportioned Illinois business Income (Per amend rtn. #1- column C= Amend. rtn. column A)	$ 28,850
Net Change reported- (RAR increase from orig. filing, decrease from amnesty amend. rtn. #1)	$ (6,962)
Apportioned Illinois business income (as corrected) (column C)	$ 21,888
Total tax paid- (as corrected from amend. rtn #1- column C)	$ 2,000
Net change- Requesting partial refund of amnesty payment	$ (500)
Total tax liability- (as corrected – per finalized RAR)	$ 1,500

Analysis:

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The amended return claiming the overpayment of $500 is denied for the following reasons:

a The $500 claim was filed beyond the 3-year filing date of the original return.

b The $500 claim was filed beyond 1 year from the Amnesty payment date of 10/8/2010.

c A Waiver (IL-872) was not secured within 1 year of the Amnesty payment date (10/8/2010), which would have extended the period for filing a refund claim.

In this example, if the taxpayer had secured an IL-872 or had filed a "protective claim" within 1 year of the amnesty payment, the $500 refund would have been allowed.___

-

b) Refund Allowed

The taxpayer filed an amended return on October 8, 2010 for the 12/31/2007 period with an amnesty payment of $1,500. The October 8, 2010 amended return estimated a pending RAR adjustment that had yet to be finalized. The taxpayer did not provide a Waiver (IL-872) with the October 8th amended return. The filing date of the original return occurred on October 15, 2008. On January 24, 2011, the taxpayer filed another amended return reporting the RAR adjustments that were finalized on January 16, 2011. The January 24th amended return is claiming a $500 overpayment of the original $1,500 Amnesty payment. The following table illustrates the taxpayer's amended return filings:

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Description (APE =12/31/2007):	Amount
Amended return # 1 – Amnesty return:	
Apportioned Illinois business Income (Per original return – as filed) (column A)	$7,850
Net Change reported- estimated RAR increase (column B)	$21,000
Apportioned Illinois business income (as corrected) (column C)	$28,850
Total tax paid- (per original return – as filed) (column A)	$492
Net change- Amnesty Payment	$1,508
Total tax paid- (as corrected) (column C)	$2,000
	Amount
Amended return # 2 – Reporting finalized RAR:	
Apportioned Illinois business Income (Per amend rtn. #1- column C= Amend. rtn. column A)	$ 28,850
Net Change reported- (RAR increase from orig. filing, decrease from amnesty amend. rtn. #1)	$ (6,962)
Apportioned Illinois business income (as corrected) (column C)	$ 21,888
Total tax paid- (as corrected from amend. rtn #1- column C)	$ 2,000
Net change- Requesting partial refund of amnesty payment	$ (500)
Total tax liability- (as corrected – per finalized RAR)	$ 1,500

Analysis:

The amended return claiming the overpayment of $500 is allowed for the following reasons:

a The $500 claim was filed within the 3-year filing date of the original return.

b The $500 claim was filed within 1 year from the Amnesty payment date of 10/8/2010.

26. OVERPAYMENT OF ESTIMATED AMNESTY LIABILITY

If a taxpayer who was under audit during the Amnesty Program Period overpaid an estimated Eligible Liability, the refund or credit allowed could not exceed the amount determined by the audit, except if the refund resulted from an issue that was not an Amnesty Issue or from the finalization of a federal change after the Amnesty Program Period. Ref: 86 Ill. Admin. Code § 520.105(k)(3).

Example: Taxpayer's income tax return for the calendar year 2007 was under audit during the Amnesty Program Period, but no Established Liability was created. The taxpayer participated in Amnesty by estimating the Eligible Liability and submitting payment with an amended 2007 return. After the audit is concluded, the Department determines that Taxpayer overpaid its 2007 liability by

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$500. Taxpayer may receive a refund of that $500, but no additional refund will be allowed unless the additional refund results from an issue that is not an Amnesty Issue or from the finalization of a federal change after the Amnesty Period.

27. UNDERPAYMENT OF ESTIMATED AMNESTY LIABILITY

If the taxpayer paid an estimated Eligible Liability during the Amnesty period, and at the close of the audit after Amnesty, the actual liability was greater than the estimated amount, the taxpayer could still have Amnesty on the estimated amount paid during the Amnesty payment period. However, in order to do so, that taxpayer must have paid the additional tax liability no later than the due date of any bill received from the Department, along with double penalties and interest (single if a Federal Change- RAR) on that additional tax liability. If the total additional tax plus the double penalties and interest on that additional tax was not paid before the due date on the bill, the Amnesty would be void, and penalties and interest would double on the entire audit liability. For Sales Taxes, the taxpayer must also sign the applicable EDA-105s. Ref: 86 Ill. Admin. Code § 520.105(j)(4)(B).

Example: A taxpayer estimated its 2008 (non-RAR) tax liability and submitted an amended return with payment for $600 during the Amnesty Program Period. At the completion of the audit on November 22, 2010, it was determined that the actual liability was $800. The taxpayer needed to pay the remaining $200, plus double penalties and interest on that $200 to preserve the abatement that was granted on the $600 payment. If the taxpayer failed to pay this by the notice due date, Amnesty would be voided and double penalties and interest would apply to the entire $800 tax liability.

28. GENERAL PROCESSING ISSUES

a) Audit Processing

Audits were conducted as usual. If the taxpayer did not contest the assessment of additional liability and paid the amount required by the due date listed on the assessment, the Department would assess the 200% Sanction only with respect to the portion of the Eligible Liability that was not paid during the Amnesty Program Period.

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If the taxpayer did not pay the full liability (tax, penalties, and interest) by the due date or contested the additional tax liability, the 200% Sanction would apply to both the additional liability and the Amnesty payment.
As long as the full liability was paid within 30 days of the interest through date listed on the audit return, a taxpayer could contest the assessment of interest or penalties by filing a claim without having the Amnesty payment subject to the 200% Sanction. A taxpayer could file a claim for reasonable cause or incorrect calculation of double penalty and interest without incurring the 200% Sanction, as long as it did not contest the tax liability itself. Ref: 86 Ill. Admin. Code § 520.105(j)(4)(B).

A taxpayer contested the additional liability when they failed to sign and pay the EDA-105 listing the additional liability, failed to pay the tax amount on the IL-870, filed a protest of the tax liability by filing an action under the Protest Act, or paid the liability and then filed a claim for refund or credit. Whenever the additional tax liability is contested unsuccessfully, the 200% Sanction applies as if no payment had been made during the Amnesty Program Period. REF: 86 Ill. Admin. Code § 520.105(j)(3)(B). Protesting the imposition or computation of penalty or interest is not contesting the liability.

A taxpayer who did not participate in Amnesty is subject to the 200% Sanction on any additional tax liability established under audit.

b) Protesting Amnesty Audit Results

Taxpayers could not protest amounts self-reported on a return filed during the Amnesty Program Period. They could only protest amounts in excess of the self-reported liability. If they did not owe additional liability, they could not protest the audit results. If they failed to sign the audit return, the auditor should have attached the signed self-reported returns and processed the audit as agreed.

> **Example:** A taxpayer was under audit for a vehicle purchased in January 2008. Based on the auditor's estimate, the taxpayer filed an RUT-25 reporting $2,000 in tax due and paid the balance during the Amnesty period. The taxpayer also petitioned ICB to review the audit. ICB determined that the auditor correctly calculated the additional liability. Since the taxpayer agreed to the liability by signing the RUT-25,

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the taxpayer cannot protest ICB's decision. Even if the audit return is not signed, penalties and interest will be abated.

If an audit results in additional liability above what the taxpayer self-reported on the return, the taxpayer could only protest the additional liability. If the taxpayer would not agree to and pay the additional liability on the return, double penalties and interest would be assessed on both the additional liability and regular penalties and interest on the liability reported on the Amnesty return. Since the amount reported on the Amnesty return is an agreed liability, the taxpayer would receive a Notice of Assessment for the additional penalties and interest on the Amnesty liability and a Notice of Tax Liability for the additional liability plus additional penalties and interest.

Example: Taxpayers were under audit for a vehicle purchased in January 2008. Based on their own estimate, they filed an RUT-25 reporting $1,500 in tax due and paid the balance during the Amnesty period. After the Amnesty period, the auditor determines that they owed $2,000. If they do not sign the audit return reporting the additional liability or pay the additional tax plus double penalties and interest, they are subject to double penalties and interest on the full $2,000. They will receive a Notice of Assessment for double penalties and interest on the $1,500. They will receive a Notice of Tax Liability for the $500 in additional tax plus double penalties and interest on that amount. They may protest this additional liability, but they may not protest the $1,500 agreed to on the Amnesty RUT-25.

29. AMNESTY PRODUCTION AND PAYMENT CODES

New Production Codes were required for the 2010 Amnesty Program in order to distinguish between Amnesty 2003 and Amnesty 2010. These new codes are used on the PROD-1, in STT, and in GenTax on the Audit Springboard production workpapers. The Production code "92" designates "2010 Amnesty Interest" and the Production code "93" designates "2010 Amnesty Penalty". These codes are used for both penalties and interest that are abated and penalties and interest that are doubled.

On the PROD-1, the Payment Code for abated penalties and interest should be listed under "AI". Doubled penalties and interest should be listed under the standard Payment Codes such as "AP", "AL", "EL", etc.

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In GenTax using “AI” should correctly show Audit’s percentage of collected vs. established (penalties and interest). Also in GenTax, coding “AI” as informational only is appropriate since this is production that will never be collected. Both STT and the DAN Program should continue to include the P & I as “AL”.

30. AMNESTY INDICATORS

GenTax indicators had to be developed for the 2010 Amnesty Program. These six indicators are:

1 **Amnesty Allow** – Indicates a user granted Amnesty to an account that did not meet the established Gentax Amnesty criteria.

2 **Amnesty Denied** – Indicates that a user manually denied Amnesty.

3 **Amnesty System Allowed** – Automatic indicator placed on an account when the account meets the Gentax Amnesty criteria.

4 **Amnesty Stop Interest** – Placed on a period (or range of periods) to stop the systematic doubling of interest for accounts not granted Amnesty. Note that once this indicator is placed on a period, it will cause all systematic Amnesty interest previously assessed to be reversed.

5 **Amnesty Stop P & I** - Placed on a period (or range of periods) to stop the systematic doubling of penalty and interest for accounts not granted Amnesty. Note that once this indicator is placed on a period, it will cause all systematic Amnesty penalty and interest previously assessed to be reversed.

6 **Amnesty Stop Penalty** - Placed on a period (or range of periods) to stop the systematic doubling of penalty for accounts not granted Amnesty. Note that once this indicator is placed on a period, it will cause all systematic Amnesty penalty previously assessed to be reversed.

These indicators are found on the Amnesty tax liability periods in GenTax.

31. AMNESTY LETTER 2010

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The Illinois Tax Delinquency Amnesty Act did not require the Department to send taxpayers written notification of Amnesty. However, the Department sent a system-generated notice to every taxpayer that had an outstanding processed liability. In addition, the Audit Bureau sent a notice to every taxpayer that was under audit (including ICB cases), had an audit completed but not processed, or was in unassigned inventory available for selection.

To view the system-generated Audit Bureau Amnesty letters, the auditor must be at the Customer Level in GenTax, not the audit springboard. These notices are available by clicking on the Letters sub-tab under the CRM Tab, then selecting the appropriate letter.

[redacted]

- See Exhibit A – 2010 Amnesty Letter.

D. 2003 ILLINOIS TAX AMNESTY PROGRAM

Note: This section is included for historical reference. It was written while the 2003 amnesty program was in effect. There may be references to tools, policies, and procedures which are no longer used by the Audit Bureau or the Department of Revenue. References throughout this section will be to the old Legacy system which is now obsolete. If you encounter an audit situation where the 2003 amnesty program may be an issue, please contact Audit Technical Support for assistance.

On June 20th, 2003, Governor Rod R. Blagojevich signed Senate Bill 969 into law as PA 93-0026. This bill, known as the "Tax Delinquency Amnesty Act," provided the opportunity for Illinois taxpayers to pay outstanding tax liabilities, file delinquent returns, and have 100% of the related interest and penalties abated.

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1 AMNESTY TIME FRAME, ELIGIBLE TAX PERIODS, AND PROVISIONS

The amnesty payment period ran from October 1, 2003 through November 15, 2003. Since November 15th fell on a Saturday, the Department accepted amnesty payments through November 17th. Regulation 521.101(a) detailed this extension until the 17th. Because of the time that it takes for electronic payments to settle, Processing was internally permitted to utilize a "soft" amnesty start date of 9/29/2003 and a "soft" end date of 11/21/2003 since the system could not identify if a payment was electronic or in check form. However, in Audit, since we knew the actual payment type and date, we only allowed amnesty for the actual amnesty period in the Statute and Regulations – October 1, 2003 through November 17, 2003. For any audit account that was granted amnesty by the System as a result of the "soft" dates, the auditor should inform the taxpayer that the payment was not received timely and they will not be granted amnesty. A comment should be made in the Auditor's Report. When the audit is processed, it should be overridden to deny amnesty.

Tax periods eligible for amnesty treatment included those ending after June 30, 1983, and prior to July 1, 2002.

The Department will abate 100% of the interest and penalties related to the tax that was paid under amnesty, and the Department will not seek civil or criminal prosecution for any taxpayer for the period of time for which amnesty has been granted. However, penalty and interest will be doubled for eligible tax periods, with the exception of pre-UPIA periods (returns due prior to 1/1/94) if a payment was not made during amnesty and it is determined that the taxpayer has a liability for the eligible period.

32. TAXES/FEES QUALIFYING AND NOT QUALIFYING FOR AMNESTY

Amnesty applied to almost all taxes collected by the Department of Revenue, such as sales, income, replacement, liquor, cigarette, hotel, and other miscellaneous taxes.

Motor Fuel Use Tax (IFTA) was the only tax collected by the Department that was not included in the amnesty program.

Amnesty did not include taxes that were collected by other Illinois agencies such as corporate franchise taxes, insurance company premiums taxes, or unemployment taxes.

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Lien filing and lien release fees, as well as bad check penalties, were not eligible for amnesty abatement.

33. PARTICIPATION IN AMNESTY

In order to qualify for amnesty, taxpayers must have had an outstanding tax liability for an eligible amnesty year/period. This included any outstanding liabilities that were currently on our system at the start of amnesty, any delinquent returns, any underreported liabilities (including RAR's in process, and RAR's that were completed) as well as any Illinois audit liabilities that were in process, recently completed but not paid, or in unassigned inventory available for selection with the potential for Illinois tax liability adjustments.

There was no application process. Unless taxpayers fell under the ineligible criteria below, they must have made full payment of their liability with a payment coupon and any required spreadsheets or returns during the amnesty period to qualify. To qualify as a payment within the amnesty period, the payment must have been either postmarked between October 1, 2003 and November 17, 2003, or must have been physically given to the Department between October 1, 2003 and November 17, 2003. A signed offset letter within these dates would also qualify as payment.

Taxpayers that were in ICB were also eligible, unless they had made an offer of disposition that had been accepted by the Department.

Taxpayers that were in Administrative Hearings were eligible, but they were required to stipulate to judgment in favor of the Department and pay the full tax liability within the amnesty payment period.

Taxpayers that were in bankruptcy were technically eligible to participate, but it was unlikely that they would. They had to receive approval from the creditors and the courts to pay the tax liability. If they were able to do so, they were to have interest and penalties abated. However, they could not be subject to the double penalties and interest if they failed to participate. They were only subject to regular penalties and interest.

To participate in amnesty, taxpayers were required to pay the entire outstanding tax liability during the amnesty payment period of October 1, 2003 through November 17, 2003. Since there was no application process, for liabilities that were already established on the system, the taxpayer was to submit payment for the entire established liability along with the Amnesty-1 payment coupon.

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For income tax audits that were in process or not yet started, the taxpayer was to submit payment for the estimated liability along with the Audit Amnesty Payment Coupon detailing the tax year and the amount of tax being paid per year. For each tax year, they were also to provide a copy of a spreadsheet (for audits that were in process) or an amended return (for audits that were not yet started or assigned) reflecting the line changes made to arrive at the payment amount. The taxpayer should not estimate overpaid years and offset that overpayment against tax due years. The taxpayer should pay, in full, all tax liability due for each tax due year within the amnesty period.

For sales tax audits, to participate in amnesty, taxpayers were to submit payment for their estimated liability along with the Audit Amnesty Payment Coupon detailing the tax periods and the amount of tax being paid per period. For sales tax audits that were not yet started or assigned, taxpayers were to provide a spreadsheet showing how they arrived at their estimated liability.

34. INELIGIBLE TAXPAYERS

Amnesty was not granted to taxpayers that were party to any criminal investigation that was ongoing during the amnesty period, or civil or criminal litigation that was pending in any circuit court, appellate court, or the Illinois Supreme Court during the amnesty period. If these taxpayers wished to participate in amnesty, they must have stipulated to judgment in favor of the Department and must have made full payment of tax during the amnesty payment period.

Any cases in the Informal Conference Board with an offer of disposition that was accepted by the Department were not eligible for amnesty.

If, as audits on amnesty years are being concluded, there is a question as to whether or not a taxpayer qualified for amnesty, the situation should be referred to Technical Support. The facts will then be forwarded to Legal Services for review. Legal Services will make the determination as to whether or not the taxpayer should be granted amnesty. Once the determination has been made by Legal Services, they will refer the case back to Technical Support. The auditor will then be responsible for informing the taxpayer in writing of Legal Services' decision.

35. TAXPAYER NOTIFICATION

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The Legislation did not require that the Department send taxpayers written notification. However, a system-generated notice was sent to every taxpayer that had an outstanding processed liability. These system-generated notices contained a listing by tax type of the taxpayer's liabilities that were pending on the system. They also contained an Amnesty-1 payment coupon for taxpayers to remit with their check in payment of the balance due. However, the system-generated notices did not include any liabilities that were not yet completed or in process by Audit.

- See Exhibit B – 2003 Amnesty Letter.
- See Exhibit C – 2003 Amnesty Payment Coupon.

Because of this, in addition to the system generated notices sent by the Department, the Audit Bureau sent out a notice to every taxpayer that was currently under audit (including ICB cases), had an audit completed but not processed, or that was in unassigned inventory available for selection. The audit notices informed the taxpayer of the availability of amnesty, but did not include a balance due amount. An Audit Amnesty Payment Coupon was included for taxpayers to remit with their estimates of their liability.

In addition to the direct mailing of notices, television, radio and newspaper ads were released, and FY Bulletin 2004-11 was mailed to tax practitioners. The FY Bulletin is available on our web site.

36. METHOD OF PAYMENT

Established tax liabilities that were already processed on the system could be paid by several methods:

a Cash, check, money order sent with the Amnesty-1 Coupon from the Notice of Tax Delinquency-Amnesty Program.

b Credit card payments for IL-1040's only via the Department Web site at www.ILtax.com or via phone at 1 800 2PAYTAX (1 800 272-9829)

c Electronic funds withdrawal via the Department Web site at www.ILtax.com or via phone at 1 800 2PAYTAX (1 800 272-9829).

Audit liabilities could be paid by three methods:

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a Cash, check or money order sent with the Audit Amnesty Payment Coupon

b Electronic funds transfer using FEDWIRE procedures outlined in Chapter 9 and Chapter 32 of the Audit Manual, sent with the Audit Amnesty Payment Coupon.

c Offsets with overpayments or pending refunds/credits at the request of the taxpayer, with the approval of the Department. Offsets from overpayments generated in an audit were to be done tax to tax, without any interest on the overpayment. If a net overpayment resulted, after the tax was paid for the amnesty liabilities, the taxpayer was to receive interest on the remainder. If the taxpayer wanted to do an offset using a pending BIT refund/credit to pay a liability under amnesty, the BIT offset policy and procedures, which are on the following pages, were to be followed.

Payment plans were not permitted for amnesty liability payments.

37. AMNESTY AND OFFSETS

The taxpayer had to provide the auditor with a letter requesting the offset be done under amnesty. The auditor was allowed to do an offset without going through the BIT Offset Committee **if** the offset was between underpaid and overpaid months/years within an audit period, **and** it did not involve a pending refund on BIT X-Logic (flag X) or offsets between tax types. The offsets from overpayments generated within the audit period should be tax-to-tax without calculating any interest on the overpaid periods. If the audit resulted in a net overpayment, the IL-870 or EDA-105 had to be signed during amnesty, and then interest would be calculated on the net overpayment. The interest should be calculated from the first overpaid month.

In income tax, if an offset was made between years, BIT will show a type 13 payment in the overpaid year and a type 10 payment in the year to which the overpayment was applied. If the payment-received date on these payments is any date within the amnesty period, they are considered amnesty payments.

On the other hand, if a taxpayer refused to accept the tax-to-tax offset, the audit period could be split into overpaid and underpaid periods at the taxpayer's request. Refund interest would be calculated on the

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overpayments, and the taxpayer would be required to pay the tax under amnesty on the underpayments without interest or penalty.

To do this for sales tax, the taxpayers were told that they needed to complete amended returns for each overpaid period due to time constraints on the auditor. The auditor could provide them the information they needed for each overpaid period, but the returns would need to be completed and submitted to the auditor for processing, along with payment for the underpaid periods prior to the end of amnesty. Based on this position, the taxpayers would not be allowed to use the overpayment and associated interest to satisfy the underpaid tax periods.

For income tax, signed amended returns are needed. Generally, taxpayers did not have to prepare the returns because the auditor would have already completed them on the overpaid years in an audit along with the EDA-25 Auditor's Reports on the underpaid years.

a) Business Income Tax Offset Policy

The Department established a Business Income Tax (BIT) Offset policy for pending refunds that are on Flag X logic. "Flag X logic" means that the account currently has a pending refund that has been verified and approved by the Department, but the funds are not currently available to pay the refund. Accordingly, BIT overpayments that are on Flag X logic are allowed to be offset with interest against liabilities within the audit period, liabilities for the same tax outside of the regular audit period and liabilities for other tax types administered by the Department. For example, any BIT overpayment can be applied to a ROT audit liability, BIT to WIT, BIT to Telecom, etc.

The following items must be completed by the auditor for a BIT offset to occur.

- Verify that there is an overpayment on the BI00 system for the FEIN under audit. The BI00 summary screen will indicate if there is an overpayment with a Flag X;

- The audit liability should be offset against the oldest BIT overpayment first. An exception for ROT and other tax type liabilities (ROT), if there is one BIT APE that will pay off the ROT liability in full as opposed to multiple APEs, use the oldest BIT overpaid year that will pay off the balance due in full.

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- Ensure that an Audit Code 4 is placed on the related FEIN and each applicable overpaid year. The Audit Code 4 will stop the processing of a refund until the offset is completed. Call or email the Audit Perfection Supervisor at [redacted] or the RTS at [redacted] to place an Audit Code 4 on the account;

- Secure from the taxpayer a signed and dated letter of authorization to offset.

  - See Exhibit D – BIT Offset Authorization Letter.

- For any offsets outside the audit period or to another tax type, attach a note on the outside of the audit file identified as "BIT Offset Request";

- Any other offset situations that are not covered, please call the ROT Perfection Section Supervisor at [redacted] or BIT Perfection Section Supervisor at [redacted], and

- The BIT Perfection Section Supervisor will be responsible, respectively, for getting the BIT offset approved by the committee once the audit is received in Springfield.

b) Business Income Tax Offset Procedures

Following is the procedure for offsetting BIT refunds on Flag X logic. These are the only types of overpayments that will be offset against established liabilities only. Do not offset overpayments to future estimated payment (ES) liabilities.

[redacted]

a [redacted]

b [redacted]

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c [redacted]

d [redacted]

38. CONSEQUENCES FOR FAILURE TO PARTICIPATE

If a taxpayer had an audit tax liability on a certain tax type that was eligible for amnesty, paid part of the liability but failed to pay all of the taxes due to the State for that particular taxable period (for sales tax) or year (for income tax), their amnesty status will be invalidated for the periods/years that are not paid in full. Interest and penalty will then be imposed on the unpaid UPIA tax liability years at a rate of 200% of the rate that would otherwise have been assessed without amnesty.

Taxpayers that qualified but chose not to participate will also be assessed 200% of penalty and interest on the entire UPIA liability found on eligible amnesty months/years
after the amnesty payment period is concluded.

Taxpayers could make payments and write on the documents that they did NOT want to participate in amnesty. These taxpayers could pay single, as opposed to double, interest and penalty, with the amended returns. These taxpayers should have paid single interest and penalty prior to the conclusion of the amnesty period, November 15, 2003.

39. AUDIT ISSUES

a) Audits Completed Prior, During, and After Amnesty

1. If taxpayers agreed to the audit **prior to the start of amnesty**, but wanted to pay under amnesty, they could sign the IL-870 or the EDA-105 unless the audit involved overpaid periods that were to be offset against underpaid periods. The auditor should not have collected payment prior to the start of amnesty. The auditor was to inform the taxpayers that they would receive a Notice of Deficiency or Notice of Tax Liability, but **they should not pay until the amnesty payment period**. **The auditor was also to tell them that if they paid before or after the amnesty payment period, their penalties and interest would not be abated** – (they would be at current rates if paid before, and would be doubled (UPIA years only) if paid after the amnesty payment period.)

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a. If the taxpayer did not sign the IL-870 or the EDA-105, the audit was to be closed as unagreed. Taxpayers were to be informed that they would be issued a Notice, but they should wait to pay during the amnesty period.

b. In both the agreed and unagreed situations, the taxpayers were to be informed that if they did not receive a Notice of Deficiency or Notice of Tax Liability (due to processing lag time) they should still make sure to pay the entire tax during the amnesty period anyway. Otherwise the tax liability would be subject to 200% penalties and interest for UPIA years.

c. If the audit resulted in a net overpayment after offsetting underpaid periods with overpaid periods, taxpayers had to sign the EDA-105 or IL-870 **during** amnesty filing dates to participate. They had to provide a letter to the auditor requesting the offset be done under amnesty. The offset would then be their payment during amnesty. There were a few cases where the audit resulted in a net overpayment, and because auditors were initially told to close cases rather than hold them until the start of amnesty, taxpayers signed the IL-870 before the start of amnesty. They were told that the offset would be their payment under amnesty. For these few cases, amnesty will be allowed since this is what the Department told the taxpayers and procedures were unclear at the time the audits were closed.

d. A copy of the Amnesty FY Bulletin 2004-11 Tax Delinquency Amnesty Act was to be given to taxpayers if they requested something in writing from us.

2. If the audit was **completed during the Amnesty Payment Period**, and the taxpayer wanted to pay, the auditor was to obtain signed EDA-105's, or IL-870's, the completed Audit Amnesty Payment Coupon and a check for the full amount of tax liability.

3. If an audit **could not be completed before the amnesty period expired**, the taxpayer could still participate in amnesty. The taxpayer could make a reasonable estimate and submit payment for the estimated amount during the amnesty payment period. If additional liability was due at the close of the audit, the taxpayer would be liable

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for double penalty and interest on the additional liability established for UPIA years. If no additional liability was due, and it was determined that the taxpayer overestimated the liability, the taxpayer will be issued a credit or refund with interest. For more information, please refer to 86 Ill Adm. Code § 521.105 (k).

b) Amnesty and Post-Amnesty Periods

If an audit period covered periods that are outside of the amnesty periods, the auditor should do the following:

For income tax, both the amnesty and post-amnesty periods can be kept in the same track and be included on the same IL-870. Since each year is processed on its own Auditor's Report for income tax, the penalties and interest would be abated on the Auditor's Report for the amnesty years and would not be abated on the Auditor's Report for the post-amnesty year.

For sales tax, the audit can remain in one track, but it will need to be split between amnesty and post-amnesty periods.

40. AMNESTY AND ADMINISTRATIVE HEARINGS

Taxpayers that were in Administrative Hearings were eligible to participate in the Amnesty program. If a taxpayer failed to participate in the program, the taxpayer will be subject to double penalties and interest on any qualifying liability. A taxpayer that wished to participate in amnesty must have stipulated to judgment in favor of the Department and paid the tax during the Amnesty payment period. For more information, please refer to 86 Ill Adm. Code § 521.105 (f).

If a taxpayer paid an estimated audit liability under amnesty, but then filed a protest to go to hearings after the audit was completed, the audit should be closed according to normal procedures and forwarded on to Administrative Hearings. The Notice of Deficiency will include double penalty and interest for UPIA years. Interest will be calculated up to the date of payment. Administrative Hearings would then make the decision on how to handle the case. They could choose to dismiss the case from hearings.

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If the case is dismissed, the taxpayer will not receive the benefits from amnesty. They will be assessed double interest and penalties on the entire audit liability. If Administrative Hearings chooses to pursue the hearing, and the Department prevails in the case, double penalties and interest would be due on the entire audit liability. If, after the hearing, the taxpayer prevails, Administrative Hearings will determine if the amnesty status will remain.

41. AMNESTY AND COURT

Each tax period for each type of tax is a separate liability that can qualify for amnesty. So, if taxpayers were in court on a ROT liability, it would not prevent them from participating in amnesty for an income tax liability that was not in court nor would it prevent them from participating in amnesty for a ROT tax period that was not in court. If they wanted to participate on the liability that was in court, they were required to dismiss their case and pay the liability during the amnesty payment period.

42. AMNESTY AND ICB

Taxpayers that were already in ICB, or those who desired to petition for a review before ICB on an incomplete audit were eligible for amnesty. The resolutions of ICB cases are not considered legal settlements. ICB matters are technically still pending, ongoing audits. Therefore, the auditor could not conclude the audit in those situations where the taxpayer requested a review of the proposed audit adjustments by ICB until ICB issued an Action Decision in the matter. If ICB ordered the auditor to make adjustments to the audit, those adjustments were considered to be part of the audit.

Since ICB is considered part of the audit process, these taxpayers could make their best estimate if amnesty would expire before the audit was to be finished, pay their potential liability, have ICB review their audit, and finish the audit in accordance with the amnesty regulations. If fieldwork were completed before amnesty and the case was already in ICB, or if fieldwork were completed during amnesty and the case was headed to ICB, taxpayers would need to pay the full amount of the liability as determined by the auditor within the amnesty payment period. This would be their “best estimate.”

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If the taxpayer won their case in ICB, they would receive a refund of any overpayment of their estimated amnesty payment, only if the auditor had informed the taxpayer of that specific situation within the audit process. If the taxpayers lost in ICB, and they owed an additional amount that was not paid during amnesty, no penalties and interest would be due on the estimated payment paid during amnesty. However, they would owe double penalties and interest only on the additional amount that was not paid under amnesty (but they must have paid it in full within 30 days of notification). If full payment is not received within 30 days of notification, then the amnesty benefits are voided on the entire audit.

If the taxpayer chose to withdraw from ICB and pay under amnesty, this was permissible; however, it was not required.

43. UNDERPAYMENT OF AMNESTY AUDIT LIABILITY

A taxpayer could participate in amnesty by completely satisfying a liability for a particular tax type and particular tax period (year, month, etc.) for which amnesty is sought. If a taxpayer had a tax period that was eligible for amnesty, and the taxpayer failed to satisfy the full amount of tax for that period, double interest and penalties would be imposed on any unpaid tax for that period. The following examples are illustrative:

For income tax, assume that the audit covered three years and the first two were paid in full during the amnesty payment period. The Auditor's Reports for the first two years would be processed with no penalties and interest since they were paid in full. Since the third year was not paid, the Auditor's Reports should reflect 200% of the penalties and interest (UPIA periods only).

For sales tax, the audit would need to be split into multiple EDA-105's. One EDA-105 should cover the amnesty months that were paid in full. No penalties and interest would be assessed on this period. Another EDA-105 should be prepared for the amnesty months that were not paid in full. This second EDA-105 would be subject to 200% penalties and interest. A third EDA-105 would be required if the audit period includes any months after June 30, 2002.

44. UNAGREED AUDIT ISSUES

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A taxpayer could not participate in amnesty on an issue-by-issue basis for the same year/period. (Ref: Regulation § 521.105(j)). They must have paid the entire liability for each amnesty liability year/period.

For income tax, this means that if a taxpayer owed $10,000 in tax on 1999 at the end of the audit, it would have to pay the entire $10,000 tax in order to qualify for amnesty and have the penalties and interest waived on that year. The taxpayer would not be able to take an unagreed issue of $2,000 for 1999 to Administrative Hearings or to Court and still have amnesty on the remaining $8,000. However, if the taxpayer had only an unagreed issue attributable to one year, and agreed issues attributable to other years of the audit period, the taxpayer could have taken amnesty for the agreed years, and could have gone to court on the unagreed year.

For sales and miscellaneous taxes, since each tax period stands on its own, it would be a rare situation in an audit where the taxpayer had only an unagreed issue in one month and agreed issues in the remaining months. The taxpayer could have gone to Administrative Hearings or Court on the unagreed issue and participated in amnesty by paying the liability on the agreed issues. However, if there were unagreed issues as well as agreed issues in the same tax period/month, the taxpayer could not separate the agreed issues from the unagreed issues, and had to pay the entire liability in order to get the benefits of amnesty.

45. PENALTY AND INTEREST ONLY LIABILITIES

There must have been a tax liability that was paid during the amnesty payment period in order for interest and penalties to be abated.

In regard to late payment penalties on accelerated payments, penalties and interest would not be abated where the tax had been paid prior to the amnesty payment period nor will penalties and interest be abated if during the course of an audit, the taxpayer finds additional tax liability not associated with the accelerated payments.

46. CIVIL FRAUD AND NEGLIGENCE PENALTIES

Civil fraud and negligence penalties do qualify for abatement under amnesty. However, excess tax collections do not qualify.

47. CHANGES MADE TO AMNESTY LIABILITY AFTER AMNESTY

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a) Claims for Refund - General

All unprocessed refund claims filed during or after amnesty for a tax period in which an amnesty payment was made will have to be accepted, partially denied or fully denied per audit. As a general rule, a taxpayer may not file a claim for any tax liability that was paid under amnesty. Section 521.105(c) of the Amnesty Regulations states, "The taxpayer relinquishes all rights to contest the tax liability that is being paid" and "the taxpayer may not claim a refund of the money paid or protest the Department's denial of such a claim." The exception to this for income tax would be a finalized federal RAR that decreased the tax liability or an RAR change that increased an NOL or created an NOL that could be carried to a year in which an amnesty payment was made. This will be addressed in the subsection that follows.

If a taxpayer paid a tax liability under amnesty and subsequently filed an amended return to claim a refund on that same period (for sales tax) or year (for income tax) for issues previously addressed under amnesty, the amended return will be denied, and a Claim Denial will be issued.

- See Exhibit E – 2003 Amnesty Claim Denial Letter.

The following examples illustrate how to handle some common income tax audit situations:

EXAMPLE: Corporation X filed its original combined return for the year 12/31/2000 on 9/10/2003 reflecting a total tax liability of $45,000. It made estimated payments in the amount of $44,000 and paid $1,000 with their original return. During the period of amnesty, the taxpayer was under audit, but the audit could not be completed prior to November 17, 2003. Therefore, on November 12, 2003 the taxpayer made an amnesty payment on an estimated audit liability in the amount of $20,000. The audit was completed on 3/10/2004 and two changes were made. Corporation Z was added to the unitary group, thereby changing Line 1 and the apportionment formula. After the audit adjustments, it was determined that the taxpayer's audit liability was overpaid by $5,000. The taxpayer did not complete an amended return to claim a refund of this amount. This is correct since the overpayment of $5,000 will be refunded after the audit is processed. Corporation X paid a total of $15,000 under amnesty. The $5,000 will be refunded **ONLY** if the auditor had informed the taxpayer that the overestimated audit liability would be indeed refunded after the audit is processed.

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Scenario 1: On 6/15/2004 Corporation X filed an amended combined return for the year ended 12/31/2000 requesting a refund in the amount of $10,000. The amended return was filed because Corporation X and subsidiaries were audited by another state to which throwback sales had been applied. The amended return filed by Corporation X removed these throwback sales from the Illinois sales factor. The amount of the change on the amended return was verified. It was not previously addressed in the audit. However, no refund is allowable since the taxpayer paid the audit liability for this year under amnesty and the change is not due to a federal audit.

Scenario 2: On 6/15/2004, Corporation X filed an amended return reversing the audit changes and requesting a refund of the $15,000 amnesty payment. The claim is denied in full. The taxpayer is sent a Notice of Claim Denial on the $15,000, due to the Amnesty rules. If the taxpayer protests the Claim Denial, Administrative Hearings will take jurisdiction. If the taxpayer loses the Administrative Hearing, the Department will issue a 200% penalty and interest assessment on the $15,000.

Scenario 3: On 6/15/2004, Corporation X filed an amended return which made changes to the apportionment factor that included issues which were addressed in the audit. Corporation X also made changes to the throwback sales as the result of an audit by another state. The total claim amount was $35,000. Of this, $5,000 was part of the original amnesty audit payment and $30,000 is due to the throwback issue. The entire claim will be denied since the changes are not due to a federal audit. The taxpayer will be assessed double penalties and interest on the entire $15,000 audit liability that was previously paid under amnesty.

b) Federal Audit Changes

Regulation 521.105(l) states in part:

> "For purposes of participating in the Amnesty Program only, a taxpayer may file an amended return reporting a federal change prior to receiving final notification from the Internal Revenue Service that the change has occurred. Although participants in the

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Amnesty Program may not seek or claim refunds, a limited exception to this rule will be permitted for taxpayers whose refund claims are based upon final determinations of the Internal Revenue Service or the federal courts."

Therefore, amended returns may be filed to report finalized federal audit changes for amnesty years, and refunds related to the finalized RAR changes may be requested for liabilities that were paid under the Amnesty program. According to Informational Bulletin FY 2005-10, however, the taxpayer must file a claim for refund within one of the following statutes of limitations: three years from the date the taxpayer's original return was filed for the taxable year, one year after a payment was made, or prior to the expiration date of a signed extension agreement with the Department. For any amended returns filed for finalized federal RAR changes, the auditor must verify that the only changes made by the taxpayer were for RAR issues. If the taxpayer made adjustments to the tax year for any issues that were not related to the RAR changes, the portion of the refund attributable to those adjustments must be denied. Following are various scenarios that the auditor may encounter with amended returns related to federal audit changes:

If a taxpayer filed an amended return to report an estimated increase for a federal audit change during amnesty, and the finalized RAR was subsequently less than the estimate, the taxpayer may file a claim for refund of the overestimated amnesty payment. If the claim is timely filed, a refund will be issued for the overpaid tax amount with interest from the payment date.

For situations where an RAR resulted in an increase to an NOL that was carried into an amnesty year, or for situations where an RAR resulted in reversing an income year to an NOL that can be carried into an amnesty year, refund claims on an amnesty year will be permitted. However, the auditor must verify that the amended return is only for the finalized RAR changes (or for a valid NOL change.) If the taxpayer makes changes to claim a refund for any other issues that were already addressed under amnesty, then amnesty will be invalidated (Regulation § 521.105(c)).-

If the taxpayer filed an amended return to report an estimated increase for a federal audit change during amnesty and the finalized RAR results in an additional liability due, no penalty will be due if the taxpayer files within 120 days of the federal finalization date. If a notice and demand is issued, and full payment is not received by the due date for payment, interest and penalties at double rates will be assessed on the amount paid under amnesty, as well as on the additional amount. –

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c) Overpayment of an Estimated Amnesty Liability

If the taxpayer made an estimate of the audit liability for an audit that was unable to be completed prior to the close of amnesty, and the taxpayer mistakenly paid penalty and/or interest along with the tax due under amnesty before the audit was completed, this will be refunded to the taxpayer as well, when the audit is processed.

If the taxpayer received a Tax Amnesty Program – Audit Liability letter from the Department, which explained the process for the estimate, and the provision for them to receive a refund of an over-estimate, they may also receive a refund of any amount of overpayment that is determined at the close of the audit. The overpayment will be refunded to the taxpayer with interest from the payment date when the audit is processed. A copy of the letter should be included in the audit file. The taxpayer may also receive a refund if the auditor verbally informed a taxpayer of the estimate procedures, and that representation is documented in the audit file. The taxpayer may file a claim for refund, in either situation if the correction is not made in processing the audit.

d) Underpayment of Estimated Amnesty Liability

If the taxpayer made an estimate of the audit liability for an audit that was unable to be completed prior to the close of amnesty, and it was determined at the close of the audit that the actual liability was greater than the estimated amount, the taxpayer can still have amnesty on the amount paid during the amnesty payment period. However, in order to do so, the taxpayer must pay the additional tax liability no later than the due date of any bill received from the Department, along with double interest that will be assessed only on the additional liability for UPIA years. If the total additional tax plus the double interest on that additional tax are not paid within thirty days, then amnesty will be void and penalty and interest will be doubled on the entire audit liability.

For example, if the taxpayer makes a $600 amnesty payment, but it is determined at the completion of the audit after amnesty is over that the actual liability is $800, the taxpayer must pay the remaining $200, plus double interest on that $200. If the taxpayer fails to pay this within 30 days, then amnesty will be void and the taxpayer will owe double interest and penalties on the entire $800 deficiency.

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e) Department Error

There are a few specific scenarios where the Department allowed amnesty because the Department made an error in information given to the taxpayer.

Following are the cases where amnesty is permitted:

1) Audit was given instructions that the auditors were to close cases (rather than hold them until the start of amnesty) for statute reasons, even if the taxpayer was planning to file under amnesty. However, these instructions created a problem. Several accounts were in a net refund situation (i.e. in income tax, the first two years are overpaid by $100 and $200 and the last year is underpaid by $160 – resulting in a net overpayment of $140). The auditors told the taxpayer that we would allow the offset under amnesty. However, the taxpayer signed the IL-870 before the start of the amnesty period. This resulted in an overpayment date (the IL-870 date) that was prior to the start of amnesty. Because the offset covered the entire tax amount, there was no tax remaining to be paid during amnesty. Since we incorrectly informed taxpayers that they would receive amnesty in this situation, and they would have waited to sign the IL-870 if they knew that was how they should receive amnesty, we will allow these taxpayers to have amnesty.

2) If an audit was completed prior to the start of amnesty, was agreed to, and payment was made on the audit liability prior to the start of amnesty, but an error was found in the audit during the Review process resulting in additional liability, and payment was made for that additional liability during amnesty, we will abate interest and penalties on the additional tax liability for the years (for income tax)/periods (for sales tax) where the amnesty payment satisfies the remaining total liability.

   For example, a taxpayer was under audit for income tax for the years 1997, 1998, and 1999. The audit was completed prior to amnesty and all issues were agreed to and paid in full prior to amnesty. After the audit, but subsequent to amnesty, an error in the audit was discovered that increased the taxpayer's tax liability for 1999. A new IL-870 is sent to the taxpayer, but it is not signed and paid until October 15, 2003 after amnesty begins. The taxpayer would receive amnesty for the 1999 tax year and all penalties and interest would be abated for this year. However, amnesty would not

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be given for 1997 and 1998 because no tax remained due for these years during the amnesty payment period.

3) If an audit was closed, and the taxpayer incorrectly paid under amnesty an amount for penalties and interest on the liability, in addition to the tax, and that penalty and interest inadvertently was not refunded when the audit was processed, the taxpayer is entitled to a refund of the penalty and interest amount. In order for the taxpayer to receive a refund of that inadvertent payment of penalty and interest, the taxpayer would need to file a refund claim.

48. PROCESSING PROCEDURES

a) AMNESTY CHECK PROCESSING

(Note: These processing procedures are obsolete in 2014, but were followed during the 2003 amnesty program.)

Checks received in the field by auditors or received in the field office with an Audit Amnesty Payment Coupon:

1) **Income Tax** – auditors and/or the field office staff should copy the checks and the payment coupon for the audit file, and then send the check and coupon **directly to Audit Perfection at P.O. Box 19012, Springfield, IL 62794-9012. The IL-1962 should not be used. Do not send checks to Document Control and Deposit.** Audit Perfection will post the check directly to the tax system and to AIS Track Information System under the payments tab. Clerical staff in the field offices should verify that the check is posted to AIS payments when they post the C-17-1 for the completed audit. If the field clerical personnel discover that a check is not posted to AIS payments, they should post it and make sure that the box is checked to indicate amnesty.

2) **Sales/Misc. Tax** – auditors and/or field office staff should follow current procedures for processing checks. The **payments will be posted to AIS in the remittance posting of the audit history by Audit Perfection**. Clerical staff in the field offices should verify that the check is posted to AIS Track Information System under the payments tab when they post the PROD-1 for the completed audit. If the field clerical person discovers that a check is not posted to AIS, the sales/misc. tax supervisor of Audit Perfection should be contacted.

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Checks received in-house by Audit Perfection or Tax Discovery with a payment coupon:

1) **Income Tax** – If the payment is received in Audit Perfection, the payment should be posted directly to the taxpayer's account by Audit Perfection based upon the tax type, years and amounts listed on the payment coupon. Copies of the check, payment coupon and any return or spreadsheet should be sent to the auditor responsible for the case. If Income Tax Discovery staff receives amnesty payments directly, they should make copies for their file, and give their checks and payment coupons to the income tax supervisor in Audit Perfection. For further information on payment posting, refer to Chapter 32, Payment Posting Procedures.

    a) Payments will be posted using the usual station numbers and appropriate forms (IDR-553, ITR-85A, WTR-1, etc.) Payment type 09 should be used for BIT field audits and payment type 25 should be used for Income Tax Discovery audits. After the payment is posted it will be visible on BIT History.

    b) The payment must also be posted in AIS Track Information System under the payments tab. The "Amnesty" box must be checked to indicate that the payment was for amnesty. Every amnesty audit payment needs to be verified by Audit Perfection to make sure the payment information is entered correctly. If the payment is for amnesty and post-amnesty periods, the payment needs to be entered in multiple parts. That way the amnesty money can be identified separately for reporting purposes.

2) **Sales/Misc. Tax Field Payments** – for registered taxpayers, payment should be posted directly to the taxpayer's account by Audit Perfection based upon the years and amounts listed on the payment coupon. For unregistered taxpayers, the money may be posted to the Remittance Clearing (RC) account. For both registered and unregistered taxpayers, the payment should be posted in the AIS Track Information System under the payment tab by Audit Perfection. The "Amnesty" box must be checked. After the payment is posted directly to the taxpayer's account, it will also be seen on STS and/or EPS. Copies of checks, payment coupons or spreadsheets should be forwarded to the auditor responsible for the case.

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3) **Sales/Misc. Tax Discovery Payments** – when received, all payments must be posted in AIS Track Information System under the payments tab by the designated clerical staff. The checks, payment coupons and any spreadsheets submitted will be given to the respective auditor responsible for the case. The auditor should prepare the appropriate document for processing. Copies of the checks, the Audit Amnesty Payment Coupon and any spreadsheets should be maintained in the audit file. The check and processing document should be given back to the clerical staff, who will forward them to Document Control and Deposit.

Checks received for taxpayers that are in unassigned inventory (status code 18 or 20):

1) **Income Tax** – the taxpayer must provide an amended return along with the payment.

   For status code 20 – the money should be posted by Audit Perfection in AIS. The amended return should then be sent to Audit Planning for analysis and proper routing to the field or Office Programs.

2) **Sales/Misc. Tax** – the taxpayer must provide a spreadsheet along with the payment and payment coupon.

   For status code 18 or 20 – the money should be posted to the taxpayer's account by Audit Perfection if the~~y~~ business is registered and to the RC account if it is unregistered. The supervisor of Sales/Misc. Tax Discovery should be given the spreadsheets, and copies of the check and payment coupon. The Sales/Misc. Tax Discovery staff will prepare the EDA-105's, based on the spreadsheet information. The Sales/Misc. Tax Discovery supervisor will review them and then forward them to the supervisor of Sales/Misc. Tax Audit Planning.

Checks that are received in the field, in field offices, or in-house without the payment coupon, spreadsheet or amended return – The person receiving the check should make an attempt to obtain the missing information. The check should be forwarded to Audit Perfection to be posted. Tax Discovery will follow up on these cases.

Checks received by the Federal State Exchange Unit:

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1 Received with a processable return and payment coupon – The check should be stapled to the return and then both the return and the payment should be sent downstairs to front-end processing.

2 Received with a payment coupon but without a return – the clerical staff should post the money on an ITR-85-A, and a either a letter should be sent to the taxpayer requesting a signed return, or an EDA-24 should be prepared and sent to the taxpayer.

3 Received with a payment coupon and a return without a signature on the return – the check should be stapled to the return and sent down to front-end processing. They will send a "no signature" letter to the taxpayer.

4 Received without a payment coupon – payment should be posted on an ITR-85-A.

49. GENERAL TAX AUDIT PROCESSING ISSUES

a) Doubling of Penalties and Interest

If any tax on an amnesty tax year is not paid during the amnesty payment period, any applicable penalties and balance due interest will be assessed.

Penalties and balance due interest **will double** on the following accounts:

- For corporate income tax UPIA tax years ending on or after 10/16/1993 through 06/30/2002;
- For IL-1040's, IL-1041's, IL-1065's, IL-1023-C's with tax years ending on or after 9/16/1993 through 6/30/2002;
- For IL-941 withholding returns, including either the annual 1993 return or the fourth quarter of 1993 return through the second quarter of 2002;
- For sales and miscellaneous taxes due on or after 01/1/94 through 06/30/2002 (including 12/93 returns); and
- Payment plans that are in default (for the above periods).

Penalty interest is calculated on the doubled penalty and then the interest is doubled. Therefore, penalty interest will essentially quadruple.

Penalty and balance due interest **will not double** on the following accounts:

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- For income tax, tax years ending prior to 10/16/1993 (The IITA was not changed to permit doubling of pre-UPIA periods);
- For IL-1040's, IL-1041's, IL-1065's, IL-1023-C's with tax years ending prior to 9/16/1993;
- For IL-941's including or before the third quarter of 1993;
- For sales and miscellaneous taxes, periods due prior to 1/1/94 (periods through 11/30/1993);
- For income tax, tax years ending after 06/30/2002 (post amnesty periods);
- Penalty and interest only accounts (not eligible for amnesty because no tax due);
- Legal settlements with any accepted offer in compromise (not eligible for amnesty);
- Bankruptcy accounts;
- Payment plans, as long as the taxpayer does not default on the pay plan;
- Taxpayers that specifically indicate with a payment that they are protesting and filing in Circuit Court prior to November 17, 2003; and
- Any payment made with the "Not Amnesty" statement.

b) Additional Liabilities on Tax Years That Were Previously Granted Amnesty

Pre-UPIA Periods - Tax years ending prior to 10/16/1993 for corporate income tax, for tax years ending prior to 9/16/1993 for IL-1040's, IL-1041's, IL-1065's, and IL-1023-C's, for IL-941 withholding returns for quarters prior to and including the third quarter of 1993, and tax periods covering through 11/30/1993 for ROT and Miscellaneous taxes (tax years/periods due prior to 1/1/1994)

- When an additional tax liability is created (due to an amended return, audit, etc.) on an amnesty tax year/period ending prior to UPIA and amnesty was previously granted, penalty and interest on the additional liability will be assessed at the pre-amnesty rate.

- If the taxpayer pays the total amount of tax, penalty and interest due within 30 days of the Department's demand for payment, the original amnesty abatement will be honored.

- If the taxpayer does not pay the total amount of tax, penalty and interest due within the 30-day period, the original amnesty

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abatement will be void and penalty and interest will be computed on the additional tax liability and the amount of tax due during the amnesty period.

When an additional tax liability is created (due to an amended return, audit, etc.) on an amnesty tax year/period prior to UPIA and the taxpayer did not owe any tax during amnesty, penalty and interest on the additional tax liability will be assessed at the pre-amnesty rate.

(1) UPIA Periods through End of Amnesty Where There is an Audit and Including Amended Returns filed During Amnesty

Tax years ending on or after 10/16/1993 through 6/30/2002 for corporate income tax, for tax years ending on or after 9/16/1993 through 6/30/2002 for IL-1040's, IL-1041's, IL-1065's, and IL-1023-C's, for 1993 IL-941 annual returns and fourth quarter 1993 withholding returns through second quarter 2002 withholding returns, and tax periods covering 12/1993 to 6/30/2002 for ROT and Miscellaneous taxes (tax years/periods due on or after 1/1/94 through 6/30/2002)

When an additional tax liability is created on an amnesty tax year under UPIA (due to an amended return, audit, etc.) and amnesty was previously granted, penalty and interest on the additional tax liability would be assessed at the doubled rate.

- If the taxpayer pays the total amount of tax and interest due within 30 days of the Department's demand for payment, the original amnesty abatement will be honored.

If the taxpayer does not pay the total amount of tax, penalty and interest due within the 30-day period, the original amnesty abatement will be void and penalty and interest will be computed on the additional tax liability and the amount of tax due during the amnesty period.

(2) UPIA Amnesty Periods Where an Amended Return is filed 11/18/2003 and after

When an additional tax liability is created on an amnesty tax year under UPIA due to an amended return (with the exception of federal RAR changes) and amnesty was previously granted, the amnesty status will be invalidated unless the additional liability is paid before

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the due date of any demand for payment and double penalty and interest will be assessed on the entire amnesty payment and the additional liability.

c) Bad Checks (NSF)

If a taxpayer completely pays an amnesty tax year liability during the amnesty payment period but the check is returned for non-sufficient funds (NSF), the following will happen:

- When the check originally comes in, the penalty and interest will be abated.

  When the check becomes NSF, the penalty and interest will be put back on the account, plus a NSF fee will be assessed.

- If the money is not repaid within the amnesty period, the penalty and interest will double at the end of amnesty.

  If the money is repaid within the amnesty period, the original penalty and interest will be abated but the NSF fee will not be abated.

d) Returns Filed

If an original or amended return is filed for an amnesty tax year after the amnesty payment period has expired and the return has a tax balance due that was not paid during the amnesty payment period, penalty and interest will be doubled.

If an original or amended return is filed for an amnesty tax year after the amnesty payment period and the tax shown on the return was paid prior to the amnesty payment period, penalty and interest will not be doubled because the liability was a $0 tax with penalty and interest only account and was not eligible for amnesty.

50. ROT & MISCELLANEOUS TAX AUDIT PROCESSING

a) Taxpayer Made an Amnesty Payment for an Audit Period during the Amnesty Payment Period

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1) The tax has been paid in full. Complete the appropriate audit document reporting penalty and interest even though they will be abated. Interest needs to be computed through amnesty payment date.

2) Taxpayer has made an estimated amnesty payment but does not pay the tax in full. Complete the appropriate audit document reporting tax paid during amnesty payment period along with penalty and interest that will be abated. Interest will be computed through the amnesty payment received date. A second audit document needs to be completed to report the additional tax liability. If the taxpayer remits the additional tax after the amnesty payment period, applicable penalty and interest will be doubled on the additional tax only. Interest will be computed through audit document signature date.

   Example: The audit period covers one period, March 2002. The taxpayer makes an amnesty payment totaling $1,000. At the close of the audit, the total tax liability is $2,000. An audit document will be completed reporting the $1,000 amnesty payment. Interest will be abated on this amount. A second document will be completed for the additional $1,000 and double interest is due.

3) Taxpayer's estimated amnesty payment does not pay the tax liability in full. If the taxpayer agrees to the additional liability but does not remit the additional amount, the amnesty payment needs to be reviewed to determine what periods are closed. When an amnesty payment does not close a period in full, applicable penalty and interest will be doubled on the entire amount for that period and forward.

   Example: The taxpayer has made a $4,800 estimated amnesty payment for period covering July 1, 2001 through June 30, 2002. At the close of the audit, total tax liability of $6,000 is due and the taxpayer does not remit the additional amount. The taxpayer is a monthly filer for ROT and the tax liability is evenly spread throughout the audit period. The amnesty payment will pay nine months in full, July 2001 through March 2002. An audit document will be completed for periods covering July 2001 through March 2002. The taxpayer will receive relief from interest and or penalty covering these periods. A second audit

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document will be completed for April 2002 through June 2002. Double interest will be computed on the additional tax due along with the amnesty payment amount allocated to April 2002. The reason that the taxpayer does not receive relief from the April 2004 amnesty payment is that they did not remit the additional amount at the close of the audit. The taxpayer's ROT filing status (monthly, quarterly, or annual) is used to determine if a period is closed.

4) At the conclusion of the audit, it was determined that the taxpayer overpaid the audit. The audit document will be completed reporting the correct liability due. The PROD-1 will also report the correct liability due. It should be noted on the audit document and letter of comments that the taxpayer is overpaid. The overpayment will be issued once the audit has been processed

b) Net Overpayment Established During Amnesty Period

1) Instead of liability due, a net overpayment is established. Complete a work schedule outlining how liability/credits fall within the amnesty period. The liability established will be offset against the credits. Once the audit is in a net overpaid situation, interest will begin accruing. Example: An audit covering the period January 2002 through June 2002 results in a net overpayment. January, February, and March have $1,000 due for each period while May has an overpayment of $5,000. Interest will be computed on the net credit of $2,000 and it will be computed in detail. The amount will be entered in May 2002. If the taxpayer made an amnesty payment for a month, we can allow credit for an overpayment for that month only if there was a representation made to the taxpayer that a refund would be allowed. Otherwise, no overpayments are allowed. If the overpayments are allowed, double penalties and interest are due on all underpayments and single interest is paid on overpayments up through the effective date of the offset.

2) The audit is completed after the amnesty payment period and it is a net overpayment. The taxpayer does not give an offset authorization letter during the amnesty payment period offsetting the liability to the credits. The taxpayer owes double

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interest on the periods where a net liability is due and single interest on periods where the net liability is overpaid. When entering tax due on the interest schedule, the ST program will take this in account.

Single interest (refund interest) will be computed on the periods overpaid and double interest will be computed on the periods underpaid. The interest schedule will report the net interest due, which will be reported on the EDA-105 documents.

Example: An audit covers the period January 2002 through June 2002 with a total net credit due of $5,000. January, March, and May have a liability of $500 due for each period. February has a credit of $2,000 and June of $4,500. The interest schedule computes double interest on the liability established for January, March, and May and single interest for February and June. The net interest will then be reported on the audit document.

c) Amnesty Codes

Amnesty code AD is pre-printed on all ROT audit documents under the free form code section. When interest and/or penalty have been doubled, the AD free form code needs to be circled. This tells Audit Perfection and Review that interest and penalty have been doubled. If the audit document does not have the AD free form code, please write it in under the free form code section and circle it.

AX, amnesty exempt, is another amnesty free form code. This code is used when the taxpayer does not qualify for amnesty. This includes bankruptcy and BCI accounts. If the taxpayer was in bankruptcy or BCI was investigating, the taxpayer does not qualify for amnesty. Penalty or interest will not be abated nor will they be doubled. Please write and circle this code under the free form code section of the audit document.

d) PROD-1 Codes

Please refer to ROT audit manual chapter 9.1.1 for PROD-1 codes.

51. INCOME TAX AUDIT PROCESSING

(Note: These processing procedures are obsolete in 2014, but were followed during the 2003 amnesty program.)

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a) Taxpayer Made an Amnesty Payment for an Audit Period That is Currently Assigned to an Auditor

1) For the Audit Amnesty Liability, with the Taxpayer in ICB for Audit Period

   - Check with the taxpayer to see if he wants to withdraw from ICB before completing the audit.
   - If the taxpayer does NOT want to withdraw from ICB, you must wait for the ICB decision before you complete the audit.
   - If the taxpayer DOES want to withdraw from ICB, he must send a letter to ICB notifying them of the withdrawal.
   - If taxpayer does want to withdraw from ICB, verify that all tax was paid and submit the audit as PD.

2) For the Audit Amnesty Liability and the Taxpayer is not in ICB

   - Complete the audit and include the amnesty payment on your Auditor's Report. The C-17-1 must be coded as PD in an amount equal to the amnesty check and any subsequent checks.
   - If the taxpayer owes an additional liability, follow the normal procedure for notifying the taxpayer of the audit liability (i.e. send an EDA-122). The taxpayer is still allowed to file for ICB.
   - If the taxpayer does not wish to file for ICB, complete the audit in the normal fashion including the Audit Coupon, etc. in the audit file. Again, the taxpayer must pay all tax (including additional tax found in the audit) due in order to receive Amnesty on the payment made.

3) Representing the Audit Liability & for a Non-Finalized RAR during your Audit Period

   - Complete the audit INCLUDING whatever the taxpayer estimated as the increase adjustment for the non-finalized RAR (the taxpayer was to provide either a spreadsheet denoting the adjustments, or an IL-1120-X).
   - If additional tax is still owed, follow normal audit liability procedures.
   - The C-17-1 and the Auditor's Comments must identify the non-finalized RAR estimate separately from other audit changes as

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code 211 to ensure proper coding on the BIT system. This is necessary so that when the RAR is finalized at a later date, it can be treated correctly for refunds or balance due.

4) For a Non-Finalized RAR Only

- Complete the audit including the non-finalized RAR adjustment.
- If additional tax is still owed, follow normal audit liability procedures.
- Identify the non-finalized RAR estimate on the C-17-1 as code 211.

b) Taxpayer Made an Amnesty Payment for Years in and Outside of the Audit Period

1) Taxpayer Filed An IL-1120-X Or Provided A Spreadsheet Showing The Adjustments For The Period Prior To Your Audit Period

- Audit Planning will set up tracks to handle these amended returns and payments and they are being sent to the field to verify.
- Verify that Column A matches BIT History. If it does not, correct it with an EDA-25. Also verify that amnesty payments are correct, and make changes for any necessary audit adjustments.
- If the adjustment is for a non-finalized RAR, include the RAR changes as specified by the taxpayer and review the return for any applicable IL audit adjustments.

2) Taxpayer Filed an IL-1120-X or Provided a Spreadsheet for a Period Subsequent to your Audit

- Audit Planning will set up a track that will include just the years filed for Amnesty.
- A regular Audit should be done for any applicable IL audit adjustments.
- Some taxpayers made payments that were non-amnesty payments or were Protest Act payments that stated the payment will be filed as a Protest Act suit. These are NOT to be considered for Amnesty. For the Protest Act cases, the audit must be completed and a Notice of Deficiency must be issued.

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Contact your supervisor for instructions before the audit is closed.

3) System Abating 804 Penalty in Error

The Federal/State Exchange Unit (FSEU) has encountered situations where the system is abating Section 804 penalty in error. The Section 804 penalty was an original return assessment filed and paid prior to the start of amnesty. When FSEU established a subsequent liability that was paid during amnesty the system could not distinguish between the penalties assessed prior to amnesty and that assessed as a result of the FSEU subsequent liability. For these cases, FSEU should do the following:

- Override the abatement of Section 804 penalty.
- If the Section 804 penalty was subsequently refunded in error, the taxpayer should be billed for the erroneous refund.

c) Amnesty Codes

Amnesty free form codes AA, AD or AK will show on the system under AMN CD on the AGGRD screens or AMN on the SUMM screen. The code will also show on the INT, PEN, INTL, PENTL, screens etc. The amnesty indicator codes 4, 5, and 6 will be visible on BIT History in third column on page 1 under “Amnesty Code”.

- AA (4) – Indicates amnesty accepted; penalty and interest abated.
- AD (5) – Indicates amnesty denied; penalties and interest doubled.
- AK (6) – Indicates amnesty penalty and interest manually abated – not doubled. (Legal settlement, protest act cases, filed in Circuit Court, accounts receivables are for penalty and interest only or payment plan)

d) Adjusting Amnesty Accounts

- Directed Payments

- Audit payments (09) paid during the amnesty payment period show received dates within the 10/1 through 11/17/03 period (03274 through 03321 Julian dates) will have to be manually directed. Systems has to see the balance due first before it can grant amnesty.

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- If the taxpayer indicated that the Amnesty payment was for a non-finalized RAR, the adjustment history of the BIT will show a code "P" for partial payment. If the taxpayer indicated that the Amnesty payment was for a finalized RAR, the adjustment history of the BIT will show a code "F" for final payment.

- If an IL1120-X was filed, the adjustment type code for the Amnesty payment will be "02."

- Audit payments (25) paid during the amnesty payment period will continue to be manually directed.

- Payments (03) paid during the amnesty payment period are undirected and will have to be manually directed. Systems has to see the balance due first before it can grant amnesty.

52. [redacted]

[redacted]

53. AMNESTY – UNIQUE AUDIT SITUATIONS

a) General Rule on Penalty Abatement at the Conclusion of an Audit

As a general rule, amnesty doubles the penalties and interest that would otherwise apply to an underpayment that is eligible for amnesty and is not paid during amnesty, but makes no other changes to the penalty provisions.

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Accordingly, any penalty that would have been abated before amnesty should be abated after amnesty.

Example #1:
XYZ Corp. is under audit by the Department and the taxpayer participated in the amnesty program by remitting an amnesty payment of $1,000,000 on November 3, 2003. At the conclusion of the examination, the auditor established $2,000,000 in liability, and the taxpayer is presented with an IL-870. On the IL-870, the auditor correctly assessed 200% interest on $1,000,000, which is the difference between the $2,000,000 established in the audit, less the $1,000,000 amnesty payment. The 200% interest assessment totaled $800,000. If the taxpayer signs the IL-870 and pays the additional $1,800,000 ($1,000,000 plus double interest of $800,000) within 30 days of the IL-870 issue date, no penalty will be assessed. If the taxpayer fails to sign the IL-870 and pay the additional $1,800,000 within 30 days of the IL-870 issuance date, the amnesty will be revoked and the auditor should assess 200% interest and 200% late payment penalty on the entire $2,000,000.

If Amnesty did not exist, the auditor would have abated the late payment penalty on the additional audit liability when the taxpayer agreed to and paid the audit liability within 30 days of the IL-870 issuance date. Hence, this general rule, as stated above applies in this situation. Amnesty does not change this, if a penalty was abated prior to amnesty, it can also be abated after amnesty. However, any additional tax liability, as well as the 200% interest amount on the difference between the tax liability established and the amnesty payment must be paid in full prior to the expiration of 30 days of the IL-870 issuance date.

Example #2:
An auditor in tax discovery was assigned an examination of ABC Corp. The auditor examined 2 amended returns filed by the taxpayer, the first amended return was filed on November 3, 2003 reporting and paying $100,000 estimating a pending RAR adjustment. The RAR adjustment was finalized on December 31, 2006 generating Illinois tax due of $150,000. A second amended return was filed on June 30, 2007 reporting and paying the additional tax of $50,000 based on the finalized RAR. When the auditor examined these returns, she correctly presents an IL-870 to the taxpayer assessing 200% interest and 200% late payment penalty on a base of $50,000, which is the difference between the finalized RAR liability of $150,000 and the $100,000 amnesty payment. Since the taxpayer did not file the 2nd amended return reporting and paying on the finalized RAR

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adjustments within 120 days, a 200% late payment penalty should be imposed on the $50,000 difference. If the taxpayer does not satisfy the entire assessment established on the IL-870 within 30 days of issuance, the amnesty is revoked and 200% of interest and late payment penalty will be computed on the entire $150,000.

These examples illustrate the application of the general rule on penalty abatement at the conclusion of an audit.

54. AMNESTY REFUND CRITERIA

The Department has established narrow guidelines that allow for any refunds of amnesty payments. There are limited situations where the Department will refund tax in a year in which an amnesty payment was made.

a) Refunds due to a Federal RAR

If the IRS finalizes an audit that reduces tax in a year in which an amnesty payment was made, any overpaid Illinois Income Tax may be refunded for that year. However, per Section 911(a)(1) of the IITA, as well as FY Bulletin 2005-10, a refund claim must be filed within the latter of:

1) three years from the date the original return was filed for the taxable year,

OR

2) one year after the payment was made.

If the Federal audit is finalized subsequent to both of the above stated dates, no refund will be allowed unless the taxpayer filed a timely claim for refund (protective claim), or the statute has been held open by a timely filed waiver (IL-872).

b) Overestimated audit liabilities

If a taxpayer was under audit by the Department and estimated the audit liability because the audit could not be completed prior to the close of amnesty, a refund of any overestimated “amnesty” tax paid, as well as any other payments made during the year, can be issued. However, the taxpayer **MUST** agree to the audit findings in order for the refund to be issued.

- **If the taxpayer fails to sign the IL-870, agreeing to the audit findings, no refunds will be issued.**

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c) Math errors

If a taxpayer filed an amnesty amended return, with remittance, and the amended return contained a math error generating an overpayment, the Department will allow the overpayment to be refunded.

d) *Amnesty* Refund Examples

Example #1:

The taxpayer filed an amended return on November 13, 2003 for the 12/31/1996 period with an amnesty payment of $1,500. The November 13, 2003 amended return estimates a pending RAR adjustment that has yet to be finalized. The taxpayer did not provide a Waiver (IL-872) with the November 13th amended return. The filing date of the original return occurred on 10/15/1997. On January 15, 2005, the taxpayer files another amended return reporting the RAR adjustments that were finalized on 12/15/2004. The January 15, 2005 amended return is claiming a $500 overpayment of the original $1,500 amnesty payment. The following table illustrates the taxpayer's amended return filings:

Description (APE =12/31/1996):	Amount
Amended return # 1 – Amnesty return:	
Apportioned Illinois business Income (Per original return – as filed) (column A)	$7,850
Net Change reported- estimated RAR increase (column B)	$21,000
Apportioned Illinois business income (as corrected) (column C)	$28,850
Total tax paid- (per original return – as filed) (column A)	$492
Net change- Amnesty Payment	$1,508
Total tax paid- (as corrected) (column C)	$2,000
	Amount
Amended return # 2 – Reporting finalized RAR:	
Apportioned Illinois business Income (Per amend rtn. #1- Column C= Amend. rtn. column A)	$ 28,850
Net Change reported- (RAR increase from orig. filing, decrease from amnesty amend. rtn. #1)	$ (6,962)
Apportioned Illinois business income (as corrected) (column C)	$ 21,888
Total tax paid- (as corrected from amend. rtn #1- Column C)	$ 2,000
Net change- Requesting partial refund of amnesty payment	$ (500)
Total tax liability- (as corrected – per finalized RAR)	$ 1,500

Analysis:

The amended return claiming the overpayment of $500 is denied for the following reasons:

1 The $500 claim was filed beyond the 3-year filing date of the original return.

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2 The $500 claim was filed beyond 1 year from the amnesty payment date of 11/13/2003.

3 A Waiver (IL-872) was not secured within 1 year of the amnesty payment date (11/13/2003), which would have extended the period for filing a refund claim.

In this example, if the taxpayer secured an IL-872, or filed a "protective claim", within 1 year of the amnesty payment, the $500 refund would have been allowed.

Example #2: The taxpayer filed an amended return on November 13, 2003 for the 12/31/1996 period with an amnesty payment of $1,500. The November 13, 2003 amended return estimates a pending RAR adjustment that has yet to be finalized. The taxpayer did not provide a Waiver (IL-872) with the November 13th amended return. The filing date of the original return occurred on 10/15/1997. On January 15, 2005, the taxpayer files another amended return reporting the RAR adjustments that were finalized on 12/15/2004. The January 15, 2005 amended return is claiming the entire refund of $1,500 paid with the amnesty return. The following table illustrates the taxpayer's amended return filings:

Description (APE =12/31/1996):	Amount
Amended return # 1 – Amnesty return:	
Apportioned Illinois business Income (Per original return – as filed) (column A)	$ 7,850
Net Change reported- estimated RAR increase (column B)	$21,000
Apportioned Illinois business income (as corrected) (column C)	$28,850
Total tax paid- (per original return – as filed) (column A)	$ 492
Net change- Amnesty Payment	$1,508
Total tax paid- (as corrected) (column C)	$ 2,000
	Amount
Amended return # 2 – Reporting finalized RAR:	
Apportioned Illinois business Income (Per amend rtn. #1- Column C= Amend. rtn. column A)	$ 28,850
Net change reported- (No change adj. from finalized RAR, decrease from amnesty return #1)	$ (21,000)
Apportioned Illinois business income (as corrected) (column C)	$ 7,850
Total tax paid- (as corrected from amend. rtn #1- Column C)	$ 2,000
Net change- Requesting full refund of amnesty payment	$ (1,508)
Total tax liability- (as corrected – per finalized RAR)	$ 492

Analysis:
The amended return claiming the overpayment of $1,508 is denied for the following reasons:

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1 The $1,508 claim was filed beyond the 3-year filing date of the original return.

2 The $1,508 claim was filed beyond 1 year from the amnesty payment date of 11/13/2003.

3 A Waiver (IL-872) was not secured within 1 year of the amnesty payment date (11/13/2003), which would have extended the period for filing a refund claim.

In this example, if the taxpayer secured an IL-872, or filed a "protective claim", within 1 year of the amnesty payment, the $1,508 refund would have been allowed.___

Example #3:
The taxpayer filed an amended return on November 13, 2003 for the 12/31/1996 period with an amnesty payment of $1,500. The November 13, 2003 amended return estimates a pending RAR adjustment that has yet to be finalized. The taxpayer did not provide a Waiver (IL-872) with the November 13th amended return. The filing date of the original return occurred on 10/15/1997. On January 15, 2005, the taxpayer files another amended return reporting the RAR adjustments that were finalized on 12/15/2004. The January 15, 2005 amended return is claiming a $1,750 overpayment, consisting of the $1,500 original amnesty payment along with an additional $250 from the finalized RAR. The following table illustrates the taxpayer's amended return filings:

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Description (APE =12/31/1996):	Amount
Amended return # 1 – Amnesty return:	
Apportioned Illinois business Income (Per original return – as filed) (column A)	$7,850
Net Change reported- estimated RAR increase (column B)	$21,000
Apportioned Illinois business income (as corrected) (column C)	$28,850
Total tax paid- (per original return – as filed) (column A)	$492
Net change- Amnesty Payment	$1,508
Total tax paid- (as corrected) (column C)	$2,000

RAR – finalized 4549 report- Finalized – 12/15/2004	Amount
Federal taxable income – as filed	**$ 7,850**
Federal Audit Adjustments	**$ (3,375)**
Federal taxable income – as corrected	**$ 4,475**

Amended return # 2 – Per taxpayer:	
Apportioned Illinois business Income (Per amend rtn. #1- Column C= Amend. rtn. column A)	$ 28,850
Net Change reported- (Taxpayer attempting to recoup RAR difference)	$ (24,375)
Apportioned Illinois business income (as corrected) (column C)(reconciling to corrected FTI)	$ 4,475
Total tax paid- (as corrected from amend. rtn #1- Column C)	$ 2,000
Net change- Requesting full refund of amnesty payment, along with partial refund of orig. tax pd.	$ (1,750)
Total tax liability- (as corrected – per finalized RAR)	$ 250

Analysis:

The amended return claiming the overpayment of $1,750 is **partially denied** for the following reasons:

1. The $1,750 claim was filed beyond the 3-year filing date of the original return.
2. The $1,750 claim was filed beyond 1 year from the amnesty payment date of 11/13/2003.
3. A Waiver (IL-872) was not secured within 1 year of the amnesty payment date (11/13/2003), which would have extended the period for filing a refund claim.

Of the $1,750 overpayment that the taxpayer is claiming, only **$242** would be allowed. The column C amounts from the **amnesty amended return** become the “as Filed “, “column A” amounts for the **2nd amended return**. The refund is limited by the Federal 4549 decrease to Federal Taxable Income reported from the finalized RAR report. Any subsequent claim adjusting the **amnesty amended return** would be **LIMITED** to the **CHANGE** reported within the finalized RAR report. In this situation, the corrected Federal Taxable income per the Finalized RAR report will **generally not reconcile** to Federal Taxable income reported to the corrected IL-1120 filings. The calculation for the **$242** refund is as follows:

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	COLUMN A	NET CHANGE	COLUMN C
Federal Taxable Income	28,850	(3,375)	25,475
Less: Exemption Amt.	(1,000)		(1,000)
Net Income	27,850	(3,375)	24,475
Income & Replacement tax	2,033	246	1,787
Less: Rep. Tax Paid Cr.	(33)	(4)	(29)
Total Inc. & Replacement tax	2,000	242	1,758

In this example, if the taxpayer secured an IL-872, or filed a "protective claim", within 1 year of the amnesty payment, the originally claimed $1,750 refund would have been allowed.

55. AMNESTY AND RESTRICTED INTEREST

"Restricted interest" is a term which is used by various areas of the Department to identify the date of overpayment for interest computation purposes in situations in which an overpayment is claimed due to the carrying of either a federal loss, Illinois net loss or Illinois excess credit.

Restricted interest can also be "assessed" in a field audit situation, where the IDOR auditor has established an additional tax liability and then offset, either a portion, or the total additional liability, with an Illinois NLD carry back. In this type of circumstance, a restricted interest assessment would be generated by Springfield, after the audit was submitted for processing.

Under the amnesty program, if the total additional tax liability was satisfied by means of an amnesty payment, as well as an offset from an Illinois net operating loss deduction that restricted interest assessment would be abated. The following example illustrates this situation:

Example:

In June of 2003, ABC Corporation was under an IDOR field audit. On November 13, 2003, ABC Corporation made an amnesty payment of $657,747 paying the entire field audit liability under the Amnesty program. Since the taxpayer paid all the balance due for 1996 and 1997, all interest and penalties, including restricted interest, was abated.

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	12/31/96	12/31/97	12/31/98
Base income as originally filed	(2,639,952)	219,309	(11,939,263)
Base Income per audit	42,467,052	7,969,850	(6,366,900)
Tax due before loss carryback	636,999	N/A	N/A
Tax due after loss carryback (from 12/98)	541,495		
Tax Due on IL-870 and paid under amnesty	541,495	116,252	0
Amount on which restricted Interest would have been billed: (636,999-541495 = 95,504)	95,504		

In this example, the taxpayer would have received a "restricted interest" assessment on the $95,504. Since the taxpayer satisfied the entire liability with the $541,495 amnesty payment, along with the Illinois NLD offset from the 12/98 period, the restricted interest assessment on the $95,504 is abated.

56. APPLICATION OF LOSSES AND CREDITS – AMNESTY EXAMPLES

The following examples analyze the Department's position on how to handle losses and credits in a Federal change situation:

a) Loss Scenario

The taxpayer filed an amended return on November 13, 2003 for the 12/31/1996 period with an amnesty payment of $1,500. The November 13, 2003 amended return estimates a pending RAR adjustment that has yet to be finalized. The taxpayer did not provide a Waiver (IL-872) with the November 13th amended return. The taxpayer is estimating an RAR increase for the 12/96 period and anticipating an RAR decrease for the 12/97 period. Since the taxpayer is expecting an RAR decrease for 12/97, no amnesty amended return was filed. The taxpayer intends to file the 12/97 amended return when the RAR is finalized. The filing dates for the original returns occurred on 10/15/1997 and 10/15/1998, respectively. On January 15, 2005, the taxpayer files 2 amended returns reporting the RAR adjustments that were finalized on 12/15/2004. The first amended return, filed on January 15, 2005, is for the 12/96 period claiming an Illinois NLD carryback from the 12/97 period. The Illinois NLD carryback was claimed from a finalized RAR decrease for 12/97. The second amended return filed on January 15, 2005 is for the 12/97 period claiming a refund due to the finalized RAR. The following table illustrates the taxpayer's amended return filings (assumes 100% Illinois apportionment):

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AMNESTY 1120X – 12/96	COLUMN A	NET CHANGE	COLUMN C
Business income apportionable to Illinois	50,000	20,890	70,890
Less: Illinois NLD	(0)	(0)	(0)
Base Income – Illinois	50,000	20,890	70,890
Less: Exemption Amount	(1,000)		(1,000)
Net Income	49,000		69,890
Income & Replacement tax	3,577		5,102
Less: Rep. Tax Paid Cr.	(59)		(84)
Total Inc. & Replacement tax	3,518	1,500	5,018

Original Return Filed – 12/97	AMOUNTS
Business income apportionable to Illinois	5,000
Less: Illinois NLD	(0)
Base Income – Illinois	5.000
Less: Exemption Amount	(1,000)
Net Income	4,000
Income & Replacement tax	292
Less: Rep. Tax Paid Cr.	(5)
Total Inc. & Replacement tax	287

RAR – Finalized 4549 Report – Finalized – 12/15/2004	**Amount**
Adjustment to Federal taxable income – 12/31/96	**$ 20,890**
Adjustment to Federal taxable income – 12/31/97	**$ (70,000)**

Amended returns filed after RAR finalization

1120X – 12/96- filed 1/15/2005	COLUMN A	NET CHANGE	COLUMN C
Business income apportionable to Illinois	70,890		70,890
Less: Illinois NLD	(0)	65,000	5,890
Base Income – Illinois	70,890	65,000	5,890
Less: Exemption Amount	(1,000)		(1,000)
Net Income	69,890		4,890
Income & Replacement tax	5,102		357
Less: Rep. Tax Paid Cr.	(84)		(6)
Total Inc. & Replacement tax	5,018	(4,667)	351

1120X – 12/97- filed 1/15/2005	COLUMN A	NET CHANGE	COLUMN C
Business income apportionable to Illinois	5,000	(70,000)	(65,000)
Less: Illinois NLD	(0)		(0)
Base Income – Illinois	5,000	(70,000)	(65,000)
Less: Exemption Amount	(1,000)		
Net Income	4,000		
Income & Replacement tax	292		-0-
Less: Rep. Tax Paid Cr.	(5)		
Total Inc. & Replacement tax	287	(287)	-0-

Analysis:

The $4,667 - 12/96 refund claimed on the amended return filed on January 15, 2005 will be allowed, even though an amnesty payment was made reporting an estimated increase to an RAR. Generally, when a taxpayer makes an amnesty payment, the year is considered closed. However, since the Illinois loss was

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generated from an RAR decrease in 12/97, the taxpayer is allowed to claim that created Illinois loss to the 12/96 period. Although the taxpayer made a $1,500 amnesty payment for 12/96, the RAR generated loss for 12/97 allows the entire $4,667 refund to be allowed.

b) Illinois Credit Scenario

The taxpayer filed an Amended return on November 13, 2003 for the 12/31/1996 period with an amnesty payment of $1,500. The November 13, 2003 amended return estimates a pending RAR adjustment that has yet to be finalized. The taxpayer did not provide a Waiver (IL-872) with the November 13th amended return. The taxpayer is estimating an RAR increase for the 12/96 period and anticipating an RAR decrease for the 12/95 period. Since the taxpayer is expecting an RAR decrease for 12/95, no amnesty amended return was filed. The taxpayer intends to file the 12/97 amended return when the RAR is finalized. The filing dates for the original returns occurred on 10/15/1996 and 10/15/1997, respectively. On January 15, 2005, the taxpayer files 2 amended returns reporting the RAR adjustments that were finalized on 12/15/2004. The first amended return, filed on January 15, 2005, is for the 12/96 period claiming an additional Illinois RT investment credit due to an RAR change that occurred in the 12/95 period. The second amended return filed on January 15th, 2005 is for the 12/95 period reporting a finalized RAR. The following table illustrates the taxpayer's amended return filings (assumes 100% Illinois apportionment):

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AMNESTY 1120X – 12/96	COLUMN A	NET CHANGE	COLUMN C
Business income apportionable to Illinois	100,000	20,890	120,890
Less: Illinois NLD	(0)	(0)	(0)
Base Income – Illinois	100,000	20,890	120,890
Less: Exemption Amount	(1,000)		(1,000)
Net Income	99,000		119,890
Income & Replacement tax	7,227		8752
Less: Rep. Tax Paid Cr.	(119)		(144)
Less: Enterprise Zone Inv. Tax Cr. (carried forward from 12/94)	(7,108)		(7,108)
Total Inc. & Replacement tax	0	1,500	1,500

Original Return Filed – 12/95	AMOUNTS
Business income apportionable to Illinois	5,000
Less: Illinois NLD	(0)
Base Income – Illinois	5.000
Less: Exemption Amount	(1,000)
Net Income	4,000
Income & Replacement tax	292
Less: Rep. Tax Paid Cr.	(5)
Less: Enterprise Zone Inv. Tax Credit (carried forward from 12/94)	(287)
Total Inc. & Replacement tax	0

RAR – Finalized 4549 Report – Finalized – 12/15/2004	**Amount**
Adjustment to Federal taxable income – 12/31/96	**$ 20,890**
Adjustment to Federal taxable income – 12/31/97	**$ (5,000)**

Amended returns filed after RAR finalization

1120X – 12/96- filed 1/15/2005	COLUMN A	NET CHANGE	COLUMN C
Business income apportionable to Illinois	120,890		120,890
Less: Illinois NLD	(0)		(0)
Base Income – Illinois	120,890		120,890
Less: Exemption Amount	(1,000)		(1,000)
Net Income	119,890		119,890
Income & Replacement tax	8,752		8,752
Less: Rep. Tax Paid Cr.	(144)		(144)
Less: Enterprise Zone Investment Tax Credit	(7,108)	(287)	(7,395)
Total Inc. & Replacement tax	1,500	(287)	1,213

1120X – 12/97- filed 1/15/2005	COLUMN A	NET CHANGE	COLUMN C
Business income apportionable to Illinois	5,000	(5,000)	0
Less: Illinois NLD	(0)		0
Base Income – Illinois	5,000	(5,000)	0
Less: Exemption Amount	(1,000)		
Net Income	4,000		
Income & Replacement tax	292		0
Less: Rep. Tax Paid Cr.	(5)		
Less. Rt Investment Tax Credit	(287)	287	0
Total Inc. & Replacement tax	0		0

Analysis:

The **$287** refund claimed on the 12/96 amended return filed on January 15, 2005 will be **allowed,** even though an amnesty payment was made reporting an estimated increase to an RAR. Generally, when a taxpayer

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makes an amnesty payment, the year is considered closed. However, due to the **RAR** decrease reported in 12/97, the originally claimed Illinois Enterprise Zone Investment Tax credit can now be utilized for 12/96.

E. EXHIBITS

EXHIBIT A – 2010 AMNESTY LETTER

2010 Tax Amnesty Program
<variable 1 tax type pulled from audit manager>, account

STATE OF Illinois DEPARTMENT OF REVENUE

Final Audit
For taxes in Gentax

<Month day, year>
<GENTAX BARCODE>
Letter ID:<>
Account ID: <# if SSN redact>

<Mailing info line #>
<NAME LINE 1>
<NAME LINE 2>
<ADDRESS>
<ADDRESS>
<CITY STATE ZIP OR FOREIGN NATION>

<ACS POSTAL scan line>

Pay eligible tax liabilities October 1, 2010, through November 8, 2010, and the penalty and interest charges will be waived.

The Illinois Department of Revenue is notifying you of the 2010 Illinois Tax Amnesty program because either an audit has recently been completed, is currently in process, or you have been selected for a possible audit. The 2010 Illinois Tax Amnesty program provides a limited opportunity for you to pay eligible tax liabilities and to have penalties and interest waived for the taxes paid in full.

What tax liability qualifies? *An eligible tax liability is unpaid tax for periods ending after June 30, 2002, and prior to July 1, 2009. If you failed to file a tax return or incorrectly reported liability due on a previously filed return for these tax periods, now is the time to make corrections and pay the tax. Liabilities that consist of only penalty and interest are* ***not*** *eligible.*

Payment must be made October 1, 2010, through November 8, 2010, using the following instructions.

- If an audit has recently been completed, or will be completed prior to the close of amnesty on November 8, 2010, you must pay the full amount of audit tax liability.
- If an audit is currently in process and cannot be completed prior to the close of amnesty on November 8, 2010, estimate the tax liability due, file the appropriate return, and pay the tax balance in full. Contact your Illinois Department of Revenue auditor for additional information. Please note that if the final audit tax liability exceeds the paid estimate, double penalties and interest may apply.
- If you are not under an audit, please review your accounts and file original or amended returns and pay any unpaid tax liability in full. If you are audited in the future, you must pay in full any additional audit tax liability or the full amount may be subject to double penalties and interest.

If an eligible tax liability is paid in full October 1, 2010, through November 8, 2010, penalty and interest will be waived.

Warning! If you do not pay your eligible tax in full, penalty and interest charges may double.

For more information on the 2010 Illinois Tax Amnesty program, visit our web site at **tax.illinois.gov**. If you have questions about your account, please call us weekdays from 8:00 a.m. to 4:30 p.m. at <variable 2 Audit phone number >.

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To pay liability

You may choose from the following options to pay "Amnesty Eligible Tax Liability".

- *Mail* us your payment with your return. Mail the return and payment to Illinois Department of Revenue, <PO Box 19012, Springfield IL 62794-9012 or PO Box 19020, Springfield, IL 62794-9020 - ***customs only***> Do not mail cash. Make your payment payable to the "Illinois Department of Revenue." To qualify for the 2010 Tax Amnesty program, mail must be postmarked with a date from the period of October 1, 2010, through November 8, 2010.
- *Pay in person* -
  - *Checks or guaranteed remittances* are accepted at **any** Illinois Department of Revenue office location: 1) district offices (for a list of locations visit our web site at **tax.illinois.gov** or call us); 2) JRTC Building, 100 West Randolph Street, Chicago, IL 60601; or 3) Willard Ice Building, 101 West Jefferson Street, Springfield, IL 62702.
  - *Cash* is **only** accepted at the following two Illinois Department of Revenue locations: the cashier's office in the JRTC Building, Concourse level, 100 West Randolph Street, Chicago, IL 60601, *or* in the Willard Ice Building, 101 West Jefferson Street, Springfield, IL 62702.

To file an original return

For each applicable tax period, complete a return, attach any required supporting documentation, and pay the tax balance for each return in full. The eligible tax liability reported on each return should be paid with a separate check or guaranteed remittance. See the return for further instructions. Mail the return and payment to Illinois Department of Revenue, <PO Box 19012, Springfield IL 62794-9012 or PO Box 19020, Springfield, IL 62794-9020 - ***customs only***>. Do not mail cash. Make your payment payable to the "Illinois Department of Revenue." To qualify for the 2010 Illinois Tax Amnesty program, mail must be postmarked with a date from the period of October 1, 2010, through November 8, 2010.

To make corrections

For each applicable tax period, complete an **amended** return, attach any required supporting documentation, and pay the tax balance for each return in full. The eligible tax liability reported on each return should be paid with a separate check or guaranteed remittance. See the return for further instructions. Mail the return and payment to Illinois Department of Revenue, <PO Box 19012, Springfield IL 62794-9012 or PO Box 19020, Springfield, IL 62794-9020 - ***customs only***>. Do not mail cash. Make your payment payable to the "Illinois Department of Revenue." To qualify for the 2010 Illinois Tax Amnesty program, mail must be postmarked with a date from the period of October 1, 2010, through November 8, 2010.

Federal Bankruptcy Court

If you are currently under the protection of the Federal Bankruptcy Court, contact us and provide the bankruptcy number and the bankruptcy court. You may participate in the 2010 Illinois Tax Amnesty program only if the court allows you to do so. Failure to pay a liability eligible for amnesty will not subject you to double penalties and interest. The bankruptcy "automatic stay" does not relieve your obligations to file tax returns.

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EXHIBIT B – 2003 AMNESTY LETTER

Illinois Department of Revenue

Tax Amnesty Program — Audit Liability

Taxpayer Name
Address
City, State, Zip

Date:
Taxpayer ID:
Track #:
Tax Types(s):

Dear Taxpayer:

The Illinois Tax Delinquency Amnesty Act was recently signed into law. This tax act could impact your account favorably. As a part of our ongoing audit process, your account is either currently under audit, has had an audit completed but not yet processed, or has been selected for a possible audit to begin within the next several months.

The Illinois Tax Delinquency Amnesty Act provides a limited opportunity for taxpayers to pay outstanding tax liabilities and to have related interest and penalties forgiven for the taxes paid during the amnesty payment period.

To qualify for the amnesty program you must

- have tax liability due for a period(s) ending after June 30, 1983, and prior to July 1, 2002;
- **not** be a party to a criminal investigation or have a civil or criminal litigation pending for any tax collected by the Illinois Department of Revenue: and
- make full payment of all amnesty tax liabilities during the amnesty payment period of **October 1, 2003, through November 17, 2003.**

Liabilities **not** covered by amnesty include

- tax periods ending on or before June 30, 1983, and ending on or after July 1 2002;
- audits that have been protested and are currently in court;
- any accepted offer in compromise or legal settlement;
- lien filing and lien release fees; and
- bad check penalties.

To participate in the amnesty program, please follow the instructions for your situation.

Recently completed audit or audit to be completed by November 17, 2003

If an audit has recently been completed but is not yet processed or paid, or the audit will be completed prior to the close of amnesty on November 17, 2003, you must make full payment of the audit tax liability during the amnesty payment period to have the penalties and interest forgiven. Send your payment and the completed payment coupon to your IDOR auditor.

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Audit in Process

If the audit is currently in process, and it cannot be completed prior to the close of amnesty, you may still participate in amnesty. Please determine an estimate of the liability due and contact your IDOR auditor. Provide the auditor with a spreadsheet showing the line changes you have made to arrive at the estimate. You must then make full payment of that amount during the amnesty payment period in order to participate in the program. Send your payment and the completed payment coupon to your IDOR auditor. If an additional liability results at the close of the audit, interest and penalties will be **doubled** on the liability not covered by the estimate. If the final audit liability is less than the estimated amount paid during amnesty, the difference will be refunded with interest from the payment date. If you do not pay the additional liability at the end of the audit, your amnesty status will be revoked and the entire audit liability will be subject to double interest and penalties.

Selected for a possible audit, or audit not yet started

If you have been selected for a possible audit or you have been notified that an audit will be conducted but it has not been started, and will not be started before the close of amnesty, you may still participate in the Amnesty Program. Determine an estimate of your liability. If you have been previously audited, you can use your prior audit results as an estimate, or you may make your own good faith estimate. Provide detailed information on a spreadsheet showing the changes used to arrive at your estimate. For income tax, you must provide an amended return reflecting the changes that you estimate. For sales tax no return is required. Send your payment for the estimated amount of tax liability and the completed payment coupon to the address below. After the audit is completed, any additional liability over the estimate will be assessed double interest and penalties. This additional liability must be paid in full at the conclusion of the audit, or amnesty will be revoked and double penalties and interest will be assessed on the entire audit liability. If the final liability is less than your estimated amount, the difference will be refunded.

Non-filed original or amended returns

If you have a non-filed original or amended return (such as for an RAR) that will not be included in the audit, complete the return(s) and write, "AMNESTY" across the top. Within the amnesty payment period, send the return to the address below along with the enclosed completed payment coupon, and the full amount of the tax liability shown on the return.

Payment options available

- electronic funds withdrawal/transfer - please contact the auditor (or the number below if you have not been contacted by an auditor) for instructions;
- cash, check, or money order sent with the enclosed payment form.

Note: Do **not** mail cash.

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Bankruptcy:

If you are under the protection of the Federal Bankruptcy Court, please contact us and provide the bankruptcy number and the bankruptcy court. The bankruptcy "automatic stay" does not relieve your obligation to file tax returns.

Amnesty conditions and terms of agreement:

By making a payment during the Illinois Tax Amnesty program dates of October 1 to November 17, 2003, for a tax period covered by the program, a taxpayer affirms and agrees

- to give up any right to contest the tax paid under amnesty,
- to give up any right to a refund or to protest the denial of any refund claim of an amnesty payment; and
- that any credit or refund of tax paid under amnesty is limited to computational error or overpayment, as determined by the department.

All amnesty payments must be received between October 1, 2003, and November 17, 2003. Otherwise, they will not qualify.

Please note that the Illinois Tax Delinquency Amnesty Act provides that penalties and interest charges will be **doubled** if an eligible taxpayer fails to satisfy the tax liability during the amnesty payment period.

For more information on the 2003 Illinois Tax Amnesty program, visit our Web site at **www.ILtax.com.** If you have questions about your account, please call us weekdays between 8:30 a.m. and 4:30 p.m. at
217 524-0434.

Illinois Department of Revenue
Audit Bureau - AMNESTY
PO Box 19012
Springfield IL 62794-9012

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EXHIBIT C – 2003 AMNESTY PAYMENT COUPON

Audit Amnesty Payment Coupon

Payment is due between October 1, 2003 and November 17, 2003

Date:

Taxpayer name
Address
City, State, Zip

Taxpayer ID:
Track #:
Tax Type(s):

Tax Type	Period Ending	Amount Per Period
Total Payment		

(If more space is needed attach an additional page using this format.)

Mailing Instructions

If you are working with an auditor, mail to the address provided by your auditor.
If you are not working with an auditor, mail to

Illinois Department of Revenue
Audit Bureau - AMNESTY
P.O.Box 19012
Springfield IL 62794-9012

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EXHIBIT D – 2003 BIT OFFSET AUTHORIZATION LETTER

I, _____, Inc., FEIN: _ _-_ _ _ _ _ _ _ _ authorize the assignment of the Business Income Tax overpayment(s) from the following tax year(s):

Tax Year	_ _/_ _ _ _	$ 00,000.00
Tax Year	_ _/_ _ _ _	$ 00,000.00

To the audit tax liability of _____, Inc., * See below instructions.

Period	_ _/_ _ _ _	$ 00,000.00
Period	_ _/_ _ _ _	$ 00,000.00

_____ _____

Signature of Authorized Officer Date

- For the applicable tax type insert the following information in place of the asterisk: Taxpayer ID #, the period needs the correct date format and the liability dollar amount. The audit liability should include tax, interest and any applicable penalties. For income tax interest computations, contact the Audit Perfection Supervisor to determine the correct amount.

Business Income Tax (BIT)

FEIN: _ _-_ _ _ _ _ _ _

Period: MM/YYYY
Audit Liability for each year in the amount of $00,000.00.

Withholding Tax (WIT)

FEIN: _ _-_ _ _ _ _ _ _

Period: Qtr/YYYY

Audit Liability for each quarter in the amount of $00,000.00

Sales Tax (ROT) & (MISC)

IBT#: _ _ _ _-_ _ _ _

Period: MM/YYYY through MM/YYYY for the audit period.
Audit Liability for the number of months in the audit period in the amount of $00,000.00

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EXHIBIT E – 2003 AMNESTY CLAIM DENIAL LETTER

If a taxpayer attempts to file refund claims in periods where they participated in the Amnesty program, the auditor should present an Amnesty claim denial letter using the language in the following example as a guideline:

Dear Taxpayer:

This letter acknowledges that we have received your IL-1120X returns, dated <date> which you submitted to amend your State taxes for <period(s)>. Our records reflect that you elected to participate in the State's Tax Delinquency Act ("Amnesty") for the tax period(s): <period(s)>. 35ILCS 745/10.

By your participation in Amnesty, you affirmed and agreed to all of the conditions contained in 86 Ill. Admin. Code 521.105(c). Specifically you agreed to: 1) relinquish all rights to contest the tax liability that is being paid; 2) not claim a refund of the money paid or protest the Department's denial of such a claim, except as expressly provided in 86 Ill. Admin. Code 521.105; 3) promptly correct any underpayment of tax liability; and 4) forgo any right you may have to withdraw from Amnesty.

Pursuant to your agreement to all of these conditions your return(s) cannot be reviewed or processed.

If you should have any questions, I can be reached at <phone #>, Fax #: <fax #>. Or you can email me at the following e-mail address: <email address>.

Sincerely,

<auditor name>
<auditor title>
Illinois Department of Revenue
<auditor address>

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Audit Procedure

Revised 3/2018

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I. PURPOSE

The purpose of this chapter is to provide basic steps needed for the conducting an Income Tax (IT) Audit.

II. REFERENCE SOURCES

A. ILLINOIS INCOME TAX ACT

- IITA § 902
- IITA § 903
- IITA § 904
- IITA § 905
- IITA § 906
- IITA § 907
- IITA § 908
- IITA § 909
- IITA § 910
- IITA § 911
- IITA § 913

B. ILLINOIS REGULATIONS AND STATUTES

- 86 IAC § 200.101 through 200.225 (Administrative Hearings)
- 86 IAC § 5000/ (Illinois Independent Tax Tribunal)
- 35 ILCS 735/ (UPIA)
- 35 ILCS 1010/ (Illinois Independent Tax Tribunal Act of 2012)

C. DEPARTMENT FORMS

- Schedule SA – Specific Accounting Method of Computing Net Income for Corporations

D. DEPARTMENT TRAINING MATERIALS

- GenTax Version 10 Computer Based Training – Department Intranet, Work Areas, GenTax

III. GENERAL INFORMATION

This chapter has been redesigned to show the steps involved in an Income Tax audit. The majority of taxpayer information can be found in GenTax. However, non-converted tax period information and BIT converted information detail is available in Legacy PDF Display – see Exhibit C, How to Locate Payment Information in GenTax and Legacy PDF Display.

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Note: Both IRIS (previous Mainframe/Legacy system information prior to GenTax) and Panagon (purged return information not available in IRIS) are no longer accessible. Legacy PDF Display has replaced both programs as the source for this type of taxpayer's financial information. See AM Chapter 46 for details for using Legacy PDF Display.

With version updates to GenTax, new terminology may be seen. The term "View" is in reference to, and can be used in place of, the term "Springboard". Example: Previously, a reference would be to the Audit Springboard, but the new reference may be Audit View instead.

- Throughout the chapter this "bullet style" has been used to indicate when an Exhibit should be reviewed at the end of the chapter. All Exhibits have been "hyperlinked", which is indicated in blue text.

A. PRIORITY AUDITS

Mandatory audits, claim audits, random audits, CID (Criminal Investigation Division) referrals and Director/Management requests receive priority treatment. Priority audits will be worked in lieu of other cases, whenever possible.

Statute expiration dates must be monitored, and action taken to finalize audits or secure waivers when necessary. Auditors must notify their supervisor regarding situations where time frames will not be met and indicate what actions are planned on the audit.

B. AGED CASES

Aged audits will be monitored, and status comments will be kept up-to-date with realistic estimated completion dates.

Level 1 & 9 Audits	Number of days aged equals **480** days old
Level 2 Audits	Number of days aged equals **600** days old
Level 3 Audits	Number of days aged equals **730** days old

C. ESTIMATED DATE OF COMPLETION (EDC)

Auditors are required to establish an estimated date of completion (EDC) for **all** audits in GenTax.

This date should be determined based on the work yet to be completed. **The date should not be continually changed.** Upon initiation, provide a realistic estimate of how long the audit will take from beginning to end. In the event an audit takes longer to complete than originally estimated, supervisors will assist the auditor in developing a documented action plan to complete the audit.

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The Work Date on the Audit Springboard in GenTax is to be used to populate the EDC. In this example a business audit view is used, however, the “Work Date” field is in the same location on the audit view for all tax types. Click on the “Add” in the “Work Date” field to open the Change Audit Detail screen.

Enter the ECD in the Work Date box, and then click the OK button.

Work Date on the Audit Springboard will then be populated with the date entered.

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D. STATUTE CONTROL

The major factor that affects the proper completion and processing of an audit is the statute date. Auditors **must** monitor all statute dates in order to ensure that the statute is not lost. An extensive explanation about statutes can be found in Chapter 21, which examines due dates, extensions, and statute control.

E. INCOME TAX RATES

Public Act 76-261 established the Illinois Income Tax Act (IITA) effective August 1, 1969. IITA § 201(a) imposes the tax, while § 201(b) governs the rates.

ILLINOIS INCOME TAX RATE HISTORY

Date	Public Act	Years Affected	Corp Tax Rate	Individual Tax Rate
August 1, 1969	PA 76-261	8/1/69 to 12/31/82	4%	2.5%
July 1, 1983	PA 83-014	1/1/83 to 6/30/84	4.8%	3.0% - temporary
September 19, 1985	PA 84-604	7/1/84 to 6/30/89	4%	2.5%
July 5, 1989/ July 1, 1991	PA 86-018/ PA 87-017	7/1/89 to 6/30/91 7/1/91 to 7/1/93	4.8%	3.0% - temporary/ extended
July 1, 1993	PA 88-089	7/1/93 to 12/31/10	4.8%	3.0% - permanent
January 13, 2011	PA 96-1496	1/1/11 to 12/31/14 1/1/15 to 12/31/24	7.0% - temporary 5.25% - temporary	5.0% - temporary 3.75% - temporary
July 6, 2017	PA 100-022	1/1/15 to 6/30/17 7/1/2017	5.25% 7.0%	3.75% 4.95%

Note: Individual tax rate also applies to trusts and estates.

Tax Rate Change in Taxpayer's Taxable Year

If a tax rate change occurs during a taxpayer's taxable year, the income is prorated for the number of days before and after the rate change. In order to prorate the income during the two rate periods, taxpayers may either elect to use:

- a number-of-days method or
- a specific accounting method.

The election must be made by the due date of the return (including extensions) and is irrevocable.

a) Number-of-days Method

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If the taxpayer elects the number-of-days method to prorate income, the number of days in each portion of the tax year (i.e. before and during the rate increase period or during and after the increase period) is divided by the total number of days in the tax year.

Proration tables appear in the instructions to the Illinois returns for the years in which the rate increase was in effect.

b) Specific Accounting Method

If the taxpayer elects to use the specific accounting method, Schedule SA must be attached to the Illinois return. Schedule SA specifically allocates income and expense items to the portion of the tax year in which they were paid, incurred or accrued. Detailed accounting records must be maintained to support the computations, and estimates are not permitted.

Schedule SA can be accessed on the Department's website (or Illinois Package X's for earlier years) for the periods in which the rate increase was in effect. Ref: Schedule SA and instructions.

F. REPLACEMENT TAX RATES

Replacement Tax rates are governed by IITA § 201(d) and were established through PA 81-1stSS-1.

ILLINOIS REPLACEMENT TAX RATE HISTORY

Date	Public Act	Years Affected	Corp Rate	Others Rate
July 1, 1979	PA 81-1stSS-1	7/1/79 to 12/31/80	2.85%	1.5%
January 1, 1981		1/1/1981 to	2.5%	1.5%

Note: Others rate of 1.5% applies to a partnership, trust or S corporation. Replacement tax is not applicable to individuals or estates.

Tax Rate Change in Taxpayer's Taxable Year

The same policy applies for a replacement tax rate change as an income tax rate change as provided above. Refer to the information in Section E above concerning number-of-days method and specific accounting method.

If the taxpayer elects to use the specific accounting method, Schedule B (Schedule R in 1980) must be attached to the Illinois return. Schedule B (or R) specifically allocates income and expense items to the portion of the tax year, in which they were paid, incurred or accrued. Detailed accounting records must be

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maintained to support the computations, and estimates are not permitted. Schedule B (or R) can be found in Illinois Package X's for the affected periods.

G. GENTAX FEDERAL TAX INFORMATION (FTI) BANNER

This information was moved to Audit Manual Chapter 1.

H. TRANSMISSION OF AUDIT FILE INFORMATION

With the advent of "electronic audits" (see table below), audit file information should be sent **electronically**. If this is not possible for some reason [dealing with large old paper audits], then a paper copy can be sent via **UPS** per Department policy – do not send audit file information through regular USPS mail. Electronic transmission is the preferred method, where applicable. Please refer to Chapter 2, General Audit Procedures.

Audit Time Frame	Type of CAF	Storage Area
Audits initiated after 10/31/2017	Electronic	GenTax – CRM Electronic Documents tab
Audits TYs 2011 and prior to 11/1/2017	Electronic	Tiamat – network storage area
Audits prior to TY 2011	Paper	Paper audits/CAFs – Stores in House

IV. PRELIMINARY AUDIT PREPARATIONS

A. ACCESSING AUDIT INVENTORY

Supervisors assign available audits to their audit staff. Audit inventory can be accessed through several pathways in GenTax.

1. My Work Manager

For quickest access click on the My Work Manager icon found in the New Manager screen.

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The My Work Manager will open showing the audits that have been assigned. The audit track number under 'Task" is hyper-linked to allow access into the audit details screen. Click on the audit track number to open that particular audit.

The audit details appear for that audit.

2. Extract File for Audits in APT

When an auditor is assigned a new audit to be completed in APT (other than an IL-1040, IL-1041 and IL-990-T audit), a file containing the most current GenTax information for the Taxpayer and account is sent to the auditor from his Supervisor. As a preliminary step prior to using the data in APT, the auditor will save the extract file to the "Libraries" "Documents" folder, this will also be where the audit file is saved. See the APT Reference Guide for additional instructions.

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B. REVIEWING THE AUDIT ASSIGNMENT

Once the audit is assigned, the information should be reviewed in order to become familiar with the case. The following list of questions (not exclusive) may be helpful in this initial review process:

- What type of company/industry is involved (manufacturing, retail, service, etc.)?
  - Internet research of the company/industry should be performed.
  - The taxpayer's 10K should be reviewed, when possible.

- What type of legal entity is involved (corporation, Subchapter S Corporation, partnership, etc.)?

- What type of Illinois returns were filed (separate basis, separate unitary, combined)?

- Is the company unitary? If a unitary search is required through GenTax, the auditor can either use the Unitary Search sub-tab, or access the Report Manager.

  See Exhibit A – How to Search for Unitary Members.

For a Unitary Business Group (UBG), research may be necessary in determining if a member is a "financial institution". Below is a link to a website, run by the FDIC, listing banks regulated by the feds, which likely qualifies them as finance companies per § 304(c). This could be a useful resource if there are suspiciously named members of a UBG and you want to verify whether or not they should be part of that group. Here's the link- just select a state and hit search to find out if the entity in question is listed as being regulated by the FDIC: https://research.fdic.gov/bankfind/

Also, if you find the bank listed and select it, you can check if it has an OCC Charter number, which is indicative of belonging to a Finance entity. Example:

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Bank (FDIC # 33831)

Active Insured Since September 8, 1993

Data as of: January 24, 2018

Bank is an active bank

FDIC Certificate#:	33831	**Established:**	September 8, 1993	**Corporate Website:**	
Headquarters:		**Insured:**	September 8, 1993	Web site not available	
		Bank Charter Class:	Savings Association	**Consumer Assistance:**	
		Primary Federal Regulator:	Office of the Comptroller of the Currency	http://www.helpwithmybank.gov	
Locations:	1 domestic in 1 states, 0 in territories, and 0 in foreign locations			**Contact the FDIC about:**	
		Secondary Federal Regulator:	N/A	Bank	

Locations | History | Identifications | Financials | Other Names / Websites

Type	Number
FDIC Unique Number (UNINUM):	48138
FDIC Certificate Number:	33831
Federal Reserve ID (RSSD-ID):	2107181
Federal Reserve ID for Bank Holding Company (RSSDHCR):	Not available or not applicable
OCC Charter Number:	716138
OTS Docket Number (historical):	18138

- Are separate unitary returns involved? If so, GenTax should be researched for all known Illinois filers. A listing of all group members, which the taxpayer has identified as Illinois filers, will be found in the UB Schedules that accompany the Illinois returns. Starting with December 31, 2010 returns and forward, the Schedule UB is part of the actual return in GenTax.

  Note: The unitary search function will not work for separate unitary because they cannot data enter the UB since it is attached to the taxpayer as an attachment.

- What years and issues were involved in the prior audit?

- Have any amended returns been filed for the current audit years or any prior years that should be examined in the current audit? Has the taxpayer filed any federal amended returns in response to a Federal RAR, and if so, was an amended Illinois return also filed?

- Are the locations of any manufacturing facilities, sales offices, warehousing facilities identified?

- Is any construction of new facilities noted?

- Are any acquisitions, mergers, spin-offs or liquidations of divisions or subsidiaries identified?

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This review process, in most cases, will bring a number of additional questions to mind. These questions should be outlined in writing. Doing this provides a basis for discussion with the taxpayer regarding the way in which the returns were filed, and what type of books and records will be needed to start the examination.

1. Requesting the Continuing Audit File

When an audit is assigned, review the Continuing Audit File (CAF) to develop an idea as to the issues contained in the prior audit and the taxpayer's position regarding those issues. To access a CAF, refer to the table that follows:

Audit Time Frame	Type of CAF	Storage Area
Audits initiated after 10/31/2017	Electronic	GenTax – CRM Electronic Documents tab
Audits TYs 2011 and prior to 11/1/2017	Electronic	Tiamat – network storage area
Audits prior to TY 2011	Paper	Paper audits/CAFs – Stores in House

For access to a paper CAF, the auditors must request the CAF through his or her supervisor who will then forward the request in an email to REV.G.ITAuditPlanning@illinois.gov. Audit Planning will reply with electronic documentation if at all possible. In some instances, if the CAF requested does not have electronic capability to be provided or the information requested is too voluminous, information will be provided via UPS.

CAFs requested by auditors/legal from outside of the Willard Ice Building, via Audit Planning from Records Management (in stores), will follow both the email tracking standards and the packaging/shipping requirements set forth in Audit File Tracking Procedures in chapter 1. See that chapter for details.

For more concerning CAF, see Section XIX Continuing Audit File.

2. Department Resources

GenTax should provide the most current taxpayer information for possible contact phone numbers and company address information. Department resources should be utilized first when performing taxpayer research in reviewing the audit assignment.

- When researching taxpayer information in GenTax, the auditor should check if a bankruptcy exists for that taxpayer. See Section 4 below on Bankruptcy for more information.

Springfield Audit Planning can be contacted to provide the following information:

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- Corporate information from Westlaw, NETS Database, Moody's, and/or the Directory of Corporate Affiliations
- Illinois returns with attachments (if specifically requested)
- Amended returns, if filed (if specifically requested)

Note: The auditor must send (email) their request for information to be obtained from audit planning to their supervisor who is to review and, if warranted, will forward the request (Form IDR-229) in an email to REV.G.ITAuditPlanning@illinois.gov. . Form IDR-229, Uniform Audit Action Request, must be used. See Section IV.F.3 for more information on the IDR-229.

3. Statute Dates

The statute date can be found in the Audit View screen for a particular audit.

However, the statute date can also been seen under the Aud Inventory sub-tab found within the Audit Tab (through the Search Manager). See Section IV.A.2.

Monitoring of this statute date is important so that the statute is not lost for proper issuance of a Notice of Deficiency (NOD) or Notice & Demand (Final Bill). Statute expiration dates must be monitored, and action taken to finalize audits or secure waivers when necessary. Auditors must notify their supervisor regarding situations where time frames will not be met and indicate what actions are planned on the audit.

See the Statute Chart in Chapter 21 for complete information on Statute of Limitations.

4. Audits of Bankruptcy Accounts

It is recommended that auditors check GenTax on audit assignments as received to see if a bankruptcy exists. It is also recommended that auditors question taxpayers on audit assignments to see whether a bankruptcy filing is involved.

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The filing of bankruptcy by a taxpayer would not necessarily alter normal audit procedure when an audit is required to establish a tax liability. Although the bankruptcy court issues an automatic restraining order which prohibits all collection attempts, this does not interfere with the Department's guaranteed right under bankruptcy law to audit the taxpayer's books and records, and issue Notices of Deficiency.

When an auditor is informed of or becomes aware of a bankruptcy during the course of an audit, the auditor should:

- contact his/her supervisor immediately. Audit activity should be suspended until the supervisor evaluates all information and determines what course of action should be taken. The audit supervisor should evaluate the audit potential in bankrupt cases in light of the case load, the available audit staff, the complexity of the case, the claim date, the travel expense and the availability of books and records.
  - If the audit supervisor determines the case to be productive, then the auditor will proceed with the audit. The supervisor should contact Collection Enforcement's Bankruptcy Unit [Bankruptcy Unit Supervisor – phone number [redacted] and advise them of the audit.
  - If the audit supervisor determines the entity should not be audited, the assignment should be cancelled. See Section F below on Audit Cancellations.

- If no bankruptcy information is indicated on GenTax but the taxpayer indicates a bankruptcy is in process, the auditor should verify the bankruptcy with the Bankruptcy Unit Supervisor (Phone [redacted] The Bankruptcy Unit needs the following information to verify a bankruptcy:
  - The bankruptcy number,
  - The bankruptcy filing date, and
  - The court where the petition was filed.

- If a bankruptcy is verified by the Bankruptcy Unit, and
  - the bar date has been set, but has not expired, the auditor should provide an estimated audit liability amount so an estimated claim may be filed, or a request for an extension to the bar date may be sought.

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- the bar date has expired, it is recommended the auditor and supervisor review and determine the audit period to be examined and contact the Bankruptcy Unit.

- An auditor should not solicit payment on the audit period up to the bankruptcy filing date, unless the taxpayer specifically requests to pay the liability. The auditor can, however, solicit a signature acknowledging agreement with the audit. On the audit period up to and including the bankruptcy, penalty and interest stop accruing as of the bankruptcy filing date.

The Department's procedures are not affected for any period following the date the bankruptcy action has been finalized.

C. REVIEWING TAX RETURNS FOR COLUMN A DETERMINATION

A review of the tax returns filed by the taxpayer is necessary in determining Column A figures needed for the Auditor's Report. This determination should be completed before the first taxpayer conference, if possible. This review requires research of both original and amended returns.

Part of this review process will be addressing work items, possible math errors and payment verification related to the taxpayer's account. When a math error is indicated on a return, a Return Correction Notice (RCN) will be generated through GenTax. A work item related to the RCN will remain open until the math error has been corrected. RCNs should be reviewed and addressed before the first appointment with the taxpayer.

1. Addressing Work Items

Work items found within GenTax can be an integral part of the audit process. Work items important to the auditor will consist of either amended returns or "math errors" (correspondence issued). The following discusses the proper procedure for addressing open work items and should be viewed as the Income Tax Audit Bureau's policy concerning such work items.

a) Auditor Responsibilities

When an audit is **assigned**, it is important for the auditor to check for open work items.

There are various types of work items that may affect the starting point of the audit. The following chart shows the work items that do **not** need to be addressed (all others will need to be "worked" as part of the audit).

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Work Items that do not need Addressed
Amended Return Received
Original Return Received
TRM Send to Files
Audit Sent to Files
2nd Level Review….
Quality Review
TP Correspondence Review

NOTE: The first three in the above chart are created Audit Planning work items that will be closed upon completion of the planning process.

- Not only should work items be checked for at the **beginning** of the audit, but the auditor should check GenTax for work items **at every stage and every time the auditor spends time working on the audit.** The appearance of work items can occur at any time, so this is crucial to ensuring the audit work is not delayed and all issues are properly addressed.

- It is also required that the auditor ask the taxpayer during the audit if they have filed amended returns. Knowing if and when the taxpayer filed their amended returns is important based on the processing time delay.

  - When a taxpayer sends in an amended return, the amended return will be entered into GenTax as a work item. There is approximately a ten (10) day span from when the amended return is received by the Department to when it appears as a work item in GenTax. (Depending on the time of year in which the amended return is received will determine the amount of time it will take to appear as an active work item.)

  - If the taxpayer presents the auditor an amended return, the auditor should refer to Chapter 39, Amended Returns and Claims, for procedures regarding amended return handling. Amended returns need to be forwarded to the ITAPTS supervisor.

(1) Work Items – Audit Years

If open work items exist for the audit year (or years), email the supervisor a request for the work items. The supervisor will verify and forward, if necessary, an email to REV.G.ITAuditPlanning@illinois.gov requesting work item retrieval.

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The requested information will be obtained and provided to the auditor.

(2) Work Items – Prior Years

If work items for prior years exist:

- And the prior years were never audited the auditor does not need to address these work items.
- And the prior years were audited, and the work items relate to amended returns, email the supervisor a request for the work items. The supervisor will verify and forward, if necessary, an email to REV.G.ITAuditPlanning@illinois.gov requesting work item retrieval. The requested information will be obtained and provided to the auditor. A determination will be made by the supervisor and the ITAPTS supervisor if the current audit should be expanded or a new audit established to handle the amended returns.

(3) Work Items – Outside Audit Period

If there are work items outside of the audit period, the auditor should contact their Supervisor to determine if the work items outside the audit period should be included in the current audit or included in a new audit.

- Adding additional years to the audit will require an expansion letter.

See Exhibit B – How to Check for Open Work Items

b) Audit Supervisor Responsibilities

The Supervisor (not the auditor) should contact Audit Planning to obtain the work items from Processing. An email should be sent to REV.G.ITAuditPlanning@illinois.gov requesting the work item.

- If a new track is needed, the request can be made at that same time by the Supervisor. All requests should be submitted in an email to REV.G.ITAuditPlanning@illinois.gov.

c) Audit Planning Responsibilities

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- Once a request is received, Audit Planning personnel should identify and request all work items for that particular taxpayer. Audit Planning will be proactive in aiding the auditor with such work items.

- If Audit Planning discovers that there are work items for periods other than the audit period, the ITAPTS supervisor and the respective geographically responsible supervisor will make a determination on how to handle them.

2. Work Items that Involve Math Error Corrections

MATH ERROR CORRECTIONS NEED TO BE COMPLETED AT THE BEGINNING OF THE AUDIT AND PROPERLY SUBMITTED TO AUDIT PERFECTION

A math error is defined in IITA § 1501(a)(12) and 86 IAC § 100.9200(a)(1)(B)(2)(A)-(E) to include, in addition to an arithmetic or computational error, any of the following:

- Entries on the wrong line.
- Omission of required supporting schedules, or forms or any of the information called for thereon.
- Any attempt to claim, exclude, deduct or improperly report, in a manner directly contrary to the Act and Regulations, any item of income, deduction or credit.

The term "math error" does not include unclaimed subtraction modifications, tax credits, or ILNLD. Addition modifications are REQUIRED to be reported on an Illinois return, however, subtraction modifications are AVAILABLE to be claimed.

IITA § 903(a)(1) –

A math error differs from a deficiency in that its assessment is governed by IITA § 903(a)(1).

- A math error liability is deemed assessed by the filing of the return. The taxpayer is notified of a math error assessment by issuance of a Notice and Demand. The Department has only three years to assess a math error and bill the taxpayer where there is a liability.

- The taxpayer has no right of protest of the math error amount.

- The only way a taxpayer can "protest" the math error is to pay the assessed amount, and subsequently, file a claim for refund. The

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Department will deny the claim and, the taxpayer then has the right to protest the denial of the claim.

- A waiver of the statute of limitations does not hold open the statute for deemed-assessed liabilities. However, there is no bar in § 903(a)(1) against the Department or the taxpayer from correcting an error (at any given time) on a return in which there is no effect on tax. Example: Correcting an Illinois Net Loss on a return.

IITA §§ 905(n) and 911(h) –

For taxable years ending prior to December 31, 2002, these two sections provide a special limitation that prevents the Department from adjusting a loss year return after the statute has expired, unless a Loss Reduction Notification Letter (LR Letter) or properly filed amended return was provided before the expiration of the statute.

- A waiver on the loss year does not extend the statute in a case for such years. In auditing years prior to December 31, 2002, this should be taken into consideration.

a) Dealing with Math Errors

Math error (M/E) corrections must be addressed for the proper processing of an audit. The importance of M/E corrections is that the 804 penalty must be re-evaluated and any credit carryforward (CCF) reinstated. Such M/Es may be outside or inside of the audit period as discussed in depth below.

The following represents a common occurrence encountered during an audit:

Taxpayer has an RCN or Bill for a tax year and asks the Auditor to assist in correcting the problems which are subject of the notice.

- This can include errors pertaining to missing/incomplete schedules (Schedule C, J, M, NLD, etc.) or missing/incompletely filed Schedule UBs.
    - These should be corrected on a priority basis to eliminate erroneous billing and prevent improper Collection assignments (see Section VI.A. on the importance of checking for collection activity on the taxpayer's account).

- Credit & loss carry forwards are most likely affected, which causes errors in subsequent tax years.

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Note: *If taxpayer does not provide evidence supporting a math error correction, no math error correction is warranted. If this is the case, any math error adjustment made must stand.*

(1) Tax Year Outside Of Audit Period

a. If necessary, the auditor should research GenTax through letters to determine the exact error(s) and what is needed to correct or reverse the M/E.
b. The auditor should discuss with the taxpayer information needed to make the correction. Taxpayer (not auditor) must complete correcting documents. Auditor can review this information before taxpayer sends it to the return address on the notice.
c. Documentation being submitted by the taxpayer should conform to Department requirements. The taxpayer should mail the correcting documentation to the return address on the notice that they had received.
d. If resolving the RCN is critical to completing the audit, the ITAPTS supervisor should be contacted for possible priority processing.

(2) Tax Year Is Within Audit Period

(a) Math Error Corrections except Schedule UB

1. At the preliminary audit stage, Auditor will identify math errors to be corrected by thoroughly researching GenTax letters & work items.

2. The auditor will obtain from the taxpayer correctly completed or missing schedules/forms (Schedule C, J, M, NLD, etc.) with applicable supporting documents.
   - Auditor should verify the accuracy and compliance of each form and the support provided.

3. The auditor will create the EDA-25 (labeled “Math Error Correction), and complete auditor comments to discuss the adjustment(s) needed and what is to be done with any overpayment, if a refund or CCF. The narrative concerning the M/E correction needs to be specific as to each issue/adjustment and what documentation has been provided.

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- If a CCF, the auditor must verify that both the received date and the CCF amount requested are correct in GenTax.
- If a data entry error, attach a copy of the documentary proof so that it can be corrected in GenTax.

~~4.~~ All M/E documentation, the EDA-25 and the narrative must be sent to the auditor's supervisor for review. After supervisory review, documents should be sent to the IT Audit Perfection supervisor via email (preferred method) or UPS.

- Copies of all documents sent to Perfection should be maintained in the audit file.

5. Perfection will notify Auditor & Supervisor by email within 5 business days of receipt that the math error correction is complete.
   - All documents received by Perfection will be case filed.

6. Pre-math error balances or overpayments, losses, and carry forwards dropped to the next year must reflect math error correction.
   - Auditor should confirm that the corrections including overpayments, losses, and carry forwards are accurate, and inform the taxpayer that problem has been corrected.

7. EDA-25s reflecting final audit adjustments will use math error EDA-25 Column C as Column A.

(b) UB Schedule Math Errors (for APEs 12/07 and After)

1. Auditor will identify math errors to be corrected during preliminary audit stage.
   - UB Schedule M/Es may be due to either a missing UB schedule or a UB schedule that needs to be corrected. Both of these corrections follow.

Missing UBs:

2. Auditor will work with taxpayer to obtain missing UB.
   - The auditor will affirm that the UB prepared by the taxpayer is prepared in a manner

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consistent with the UB Instructions, including proper calculations.

Corrected UBs:

3. Auditor will work with taxpayer to obtain corrected UB.
   - The auditor will affirm that the UB prepared by the taxpayer is prepared in a manner consistent with the UB Instructions, including proper calculations.

The following apply for both missing and corrected UBs.

4. The auditor will send the UB along with a revised EDA-25 to their supervisor for review.
   - Included in the narrative should be a thorough discussion explaining the specific areas of the UB that had changed from what was submitted with the returns filed. This will help Perfection personnel locate the specific UB entry to be corrected.

5. After supervisory review, documents should be sent to the IT Audit Perfection supervisor via email or UPS.
   - Copies of all documents sent to Perfection should be maintained in the audit file.
   - If posting the UB becomes labor intensive, Audit Perfection will determine when to forward to Data Entry for entering. Once the Schedule is entered, Audit Perfection can adjust the account and correct the balances, drop carry forwards, etc.
   - All documents received by Perfection will be case filed.

6. Perfection will notify Auditor & Supervisor by email within 5 business days of receipt that the math error correction is complete.

7. Pre-math error balances or overpayments, losses, and carry forwards dropped to the next year must reflect math error correction.
   - Auditor should confirm that the corrections including overpayments, losses, and carry forwards are accurate, and inform the taxpayer that problem has been corrected.

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8. EDA-25s reflecting final audit adjustments will use math error EDA-25 Column C as Column A.

b) Completed Math Error Correction EDA-25

The following is an example of an APT EDA-25 indicating a math error correction. The taxpayer (had received an RCN) provided the missing Illinois special bonus depreciation support to the auditor so that the math error could be corrected. This support indicated that the actual amount was $300,000,000, which was corrected on this “math error” EDA-25.

The “Math Error Correction” EDA-25, the support documentation, and Auditor’s comments explaining the math error correction must be sent to the RAS for review. After RAS review, all documentation will be sent to Audit Perfection for the taxpayer’s account to be adjusted/corrected.

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Illinois Department of Revenue

EDA-25 IL-1120 Auditor's Report

Taxpayer name: [redacted]
FEIN:
Account ID:

Tax period ending: 12/31/2012
Interest through date:
Earliest statute date: 10/15/2016
Audit period: 12/31/2012 through 12/31/2012

Type of change: ☒ Math error
Amended change: ☐ Federal ☐ State
If this is a federal change, the finalization date is

Original return receive date:
Amended receive date:

Capital Loss	Column A (original or adjusted)	Column B (net change)	Column C (corrected amounts)
Capital Loss Carry Back Line 1 Adjustment	0	0	0
Capital Loss Federal Taxable Income	0	0	0

Step 1: Income or loss					
1 Federal taxable income	1	3,536,799,423	0	1	3,536,799,423
2 Net operating loss deduction from U.S. Form 1120, Line 29a	2	0	0	2	0
3 State, municipal, and other interest income excluded from Line 1	3	8,115,375	0	3	8,115,375
4 Illinois income and replacement tax deducted from Line 1	4	8,005,156	0	4	8,005,156
5 Illinois special depreciation addition	5	212,945,915	87,154,085	5	300,000,000
6 Related-party expenses additions	6	195,981,458	0	6	195,981,458
7 Distributive shares of additions	7	318,374,294	0	7	318,374,294
8 Other additions	8	0	0	8	0
9 Add Lines 1 through 8. This amount is your income or loss.	9	4,278,121,621		9	4,365,275,706

Step 2: Base income or loss					
10 Interest income from U.S. Treasury and other exempt federal obligations	10	859,712	0	10	859,712
11 Enterprise Zone or River Edge Redevelopment Zone dividend subtraction	11	0	0	11	0
12 Enterprise Zone or River Edge Redevelopment Zone interest subtraction	12	0	0	12	0
13 High Impact Business dividend subtraction	13	0	0	13	0
14 High Impact Business interest subtraction	14	0	0	14	0
15 Contribution subtraction	15	0	0	15	0
16 Contribution to certain job training projects	16	0	0	16	0
17 Foreign dividend subtraction	17	1,721,667,100	0	17	1,721,667,100
18 Illinois special depreciation subtraction	18	93,496,938	0	18	93,496,938
19 Related-party expenses subtraction	19	0	0	19	0
20 Distributive share of subtractions	20	67,677,572	0	20	67,677,572
21 Other subtractions	21	6,467,193	0	21	6,467,193
22 Total subtractions. Add Lines 10 through 21.	22	1,890,168,515		22	1,890,168,515
23 Base income or net loss. Subtract Line 22 from Line 9.	23	2,387,953,106		23	2,475,107,191

Step 3: Income allocable to Illinois *(Complete this step if any amount on Line 23 is derived outside Illinois.)*					
24 Nonbusiness income or loss	24	0	0	24	0
25 Trusts, estates, and non-unitary partnership business income or loss included in Line 23	25	0	0	25	0
26 Add Lines 24 and 25.	26	0		26	0
27 Business income or loss. Subtract Line 26 from Line 23.	27	2,387,953,106		27	2,475,107,191
28 Total sales everywhere. This amount cannot be negative.	28	99,816,889,290	0	28	99,816,889,290
29 Total sales inside Illinois. This amount cannot be negative.	29	2,671,925,148	0	29	2,671,925,148
30 Apportionment factor. Divide Line 29 by Line 28. *(carry to six decimals)*	30	0.026769		30	0.026769
31 Business income or loss apportionable to Illinois. Multiply Line 27 by Line 30.	31	63,923,117	2,333,027	31	66,256,144
32 Nonbusiness income or loss allocable to Illinois.	32	0	0	32	0
33 Trusts, estates, and non-unitary partnership business income or loss apportionable to Illinois.	33	0	0	33	0
34 Base income or net loss allocable to Illinois. Add Lines 31 through 33.	34	63,923,117		34	66,256,144

EDA-25 front (R-06/14)

c) General Reminders

M/E corrections:

- Cannot decrease additions or increase subtractions/credits beyond the original amounts entered by the taxpayer on their return (i.e. reinstate original amounts).
- May warrant the re-evaluation of the 804 penalty, and reinstatement of any credit carryforward (CCF).
- Should be addressed before the auditor issues any EDA-122.
- Are not included in audit assessments (EDA-122 or IL-870) or the PROD-1.
- Should be addressed (if possible) at the same time. It is beneficial to all parties (auditors, supervisors, and Perfection staff) that multiple corrections be submitted for correction together. This prevents potential delays in the audit process.

3. Verifying Payments

a) Payment History

It is necessary to reconcile the payments reported by the taxpayer on the return as filed with the payments on the taxpayer's account on GenTax. If additional payments are claimed by the taxpayer that do not appear in GenTax, the taxpayer will need to provide proof of payment by giving the auditor a copy of the cancelled check or electronic payment verification information. Using the information provided, the auditor needs to research to find the payment.

If found, the auditor's comments should clearly state the status of the payment and how Perfection is to restore that payment to the taxpayer's account. **Note**: Screen prints of where the payment is found need to be included with the audit file to support the reinstatement of the missing money.

Payment panel in GenTax:

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[redacted]

b) GenTax/Legacy PDF Display

When viewing GenTax payment ("converted credits") information, any payment identified with a Trans Type including "Cnv" in the description can be viewed in Legacy PDF Display. See AM Chapter 46 for details on accessing/using Legacy PDF Display.

[redacted]

When the payments in the Mainframe/Legacy system were converted to GenTax only the net amounts were converted. Therefore, Legacy PDF Display will have to be accessed to see the full details for the payments, the credit carryforwards, and the refunds for filing periods that have converted data.

The Business Income Tax System code reference card (EDA-78) is a convenient reference source when reviewing taxpayer information in Legacy PDF Display, but not in the GenTax system. If the auditor should need the latest version (revised 6/07) of the EDA-78, contact Audit Planning.

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Note: Any needed information that would have been previously accessed in either IRIS or Panagon (purged history) can now be accessed in Legacy PDF Display.

- **See Exhibit C – How to Locate Payment Information in GenTax and Legacy PDF Display.**

c) Deactivated Credits

Deactivated credit(s) will be seen on years where a statute has expired on an overpayment. Deactivating an overpayment credit prevents the system from trying to refund money the taxpayer is not entitled to receive. Deactivated credit can however be used to offset additional tax liability.

Example #1: Taxpayer has deactivated credit of $2,000. This money cannot be refunded, but if additional liability is reported at a later date, then the deactivated credit is able to be applied up to the liability amount. It still cannot create a refund. At a later date, additional liability of $1,500 is determined, so $1,500 of the deactivated credit can be applied to cover this liability.

Example #2: Audit situation – The taxpayer has an RAR and has utilized ILNLDs that they did not have. Audit liability is determined to be $1,625,000. There is a deactivated credit in GenTax for $1,300,000, so this amount can be applied against the $1,625,000 liability.

Example of a deactivated credit as appears in GenTax:

4. Column A Determination

Once work items have been addressed, any math errors corrected and payments verified, Column A figures can be determined.

- **See Exhibit D – How to Determine Column A Figures.**

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D. STOP BILL INDICATORS

Every effort is made by Planning to ensure tax years under audit that have a balance due amount as a result of an RCN on an original return that is yet to be resolved have a "Stop Bill" indicator in place to prevent premature collection activity. However, if the taxpayer did not respond to the Department's letter prior to audit assignment, there may be occasion for a stop bill indicator to be placed on an account. The taxpayer would need to provide the necessary documentation to have the auditor complete a math error correction per Section C.2. above.

If there is a need to create a stop bill indicator, the request and documentation (taxpayer response to the RCN issue) should be forwarded to the appropriate ADM. Approved requests will be forwarded to the Perfection supervisor in Income Tax, who will place stop bills on these approved requests.

Once placed on the account, the Stop Bill indicator will remain until the math error is corrected or the audit is processed.

E. PERFORMING COMPLIANCE CHECKS

This information was moved to Audit Manual Chapter 2.

F. AUDIT CANCELLATIONS

Note: Cancellations are for those cases that have already been assigned and/or started and are in the "Assigned – Started" stage.

1. Cancellation Reasons

A cancellation request must be submitted on Form IDR-229 if the reason(s) meet one or more of the seven cancellation reasons listed as follows:

1) The business has been discontinued and neither the taxpayer nor the books and records can be located, and no open periods exist.

2) The business has been discontinued, books and records are available, but the audit period is too short.

   - If the business is discontinued, and no change has been made, the discontinuation date should be firmly established, verified and documented via the completion of a REG-C-3, Business Information Update. The REG-C-3 can be found on the Department's website under Forms then Registration.

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3) The issue that generated the audit is no longer valid (e.g. law changes, hearing and court decisions, IDOR policy, previous filing errors corrected), and there appears to be no additional area(s) of potential non-compliance.

4) It is suspected that the liability of a follow-up Mandatory audit will be zero or immaterial. Thorough documentation is required to validate potential audit results.

5) An out-of-state company's Illinois activities can be documented to be zero or very minimal and travel expenses to do the audit appear to be greater than the potential liability that could be generated.

6) Insufficient staffing due to higher priorities.

7) Duplicate Track.

2. Reasons not to Request an Audit Cancellation

A cancellation request will not be approved for any of the following reasons:

1) The taxpayer is uncooperative in providing records.

2) The taxpayer's records are not adequate and appear to be unreliable, making the completion of an audit difficult.

3) The taxpayer has discontinued and cannot be located, but the books and records are available from outside sources to substantiate a tax liability.

4) Randomly selected audits that may appear to be non-productive. However, the scope of the audit can be limited to reviewing only those areas necessary to assure the auditor that the taxpayer is in fact basically in compliance.

5) Generally, when taxpayer contact has been made and/or some review of books and records performed.

   [redacted] The respective Audit Initiation Indicator must be ceased, "Inf-Audit Initiation" transaction reversed, a cancellation letter (form EDA-140) is mailed to the taxpayer [only issued when an audit initiation letter had been sent to the taxpayer]. This will be done by the Audit Planning staff.

6) Claim audits.

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7) Taxpayer books and records are located in an unsafe environment. Attempts should be made to have books and records given to the auditor at another location.

Note: Request for cancellation for tracks that have [redacted] or more charged will require additional information explaining the reason for the extra hours to be considered for approval.

3. Form IDR-229

Form IDR-229 (Uniform Audit Action Request) must be prepared for all cancellation requests. The approved Form IDR-229 (a savable fill-in pdf) is available under Forms in the Audit Work Area on the sp●IDOR web. DO NOT use your own created IDR-229.

- The auditor's supervisor must approve all cancellation requests.
- All reasons, work papers and information sources utilized in arriving at the conclusion that the audit should be cancelled must be included with the IDR-229. Approved IDR-229s (with any supporting documents) should be emailed by the RAS to REV.G.ITAuditPlanning@illinois.gov.

The IDR-229 will also be used for Audit mergers or transfers, change in Designated Agent (DA), and request for data. Form IDR-229-UB, Change of Designated Agent, should be used in conjunction with the IDR-229 when changing the DA, and can be accessed in the Audit Work Area under Forms on the sp●IDOR web. Completed IDR-229s should be emailed by the RAS to REV.G.ITAuditPlanning@illinois.gov. For more information on both forms, see Chapter 23, Unitary Determination.

4. No Liability Audits

Generally, **no** audit should be recommended for cancellation where taxpayer contact has been made and/or there has been some review of the books and records.

- After the Auditor is satisfied that the taxpayer is basically in compliance, the audit must be documented and closed as a no liability, "NL".

- Audits in which the taxpayer has been contacted and relevant issues of the case have been examined, but the audit adjustment(s) would result in no additional liability or an additional liability below established tolerances, should be processed as No Liability (NL) audits. These audits should be concluded with the minimum required workpapers.

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- Audits in which no additional liability is established, but adjustments are made that reduce a claimed net operating loss or excess credit amounts should be considered Loss Reduction (LR) audits IF EDA-25s OR IL-1120Xs are completed. However, audits involving net operating loss or excess credit year adjustments should be considered **NL** audits IF NO EDA-25s OR IL-1120Xs are completed. See Chapter 35 for more information on these types of audits.

5. Audits Which Could Result in Overpayments

During the course of an audit it may become apparent that the taxpayer has actually overpaid the tax liability. If it is determined that the taxpayer is overpaid, and it will take a substantial amount of time to complete the audit, the Auditor can request that the taxpayer determine the amount of the overpayment and prepare an amended return. The Auditor can review the amended return and verify that the overpayment is correct.

Note: Effective January 1, 2015, PA 98-0925 provides for a change to IITA § 909 as to the application of overpayments. The taxpayer can request overpayments on an original or amended return to be applied as an estimated payment to a future tax year. If no specific tax year has been supplied, the overpayment will be applied to the next applicable ES payment due date.

In the following situations the audit should be completed. When the audit is processed the refund, if requested, will be generated (if within statute).

- If a substantial amount of time (determined by conferring with your supervisor) has been spent on the audit and the case is near completion
- If a claim has been filed by the taxpayer and is included in the audit assignment. IN ALL CASES, THE CLAIM MUST BE APPROVED, ADJUSTED OR DENIED BY THE AUDITOR.
- If an audit reversal of a “math error” results in an overpayment.
- If one year of the audit results in a substantial deficiency and another in an overpayment and the net result is an overpayment.

V. CONTACTING THE TAXPAYER

Auditors **must** initiate contact with taxpayers within **15 days** of receiving an audit assignment. A Notice of Audit Initiation must be issued at that time. Audit appointments must be scheduled and entered on the field auditor’s calendar within the same 15-day period. If the audit is one that requires multiple appointments, the anticipated number of appointments should be scheduled at the same time of the initial appointment.

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A. SCHEDULING APPOINTMENTS

- The initial contact with the taxpayer is generally by telephone. Any appointments or requests for information should be confirmed in writing (see Audit Initiation Letter below). In this way adequate documentation is available in the audit package if the taxpayer is found to be uncooperative at a later date.

- To the extent that an audit is expected to take longer (based on history, etc.) than the time allotted in an audit appointment, it would be helpful to schedule as many weeks as possible when the initial appointment is being scheduled.

  - For example, if the previous audit took 70 hours to complete, it would be beneficial to schedule the 2nd week when scheduling the 1st week. This is appropriate even if the 2nd appointment is weeks after the initial one.

- All attempts should be made to keep any audit appointment, which is made and confirmed. If the situation arises in which it is impossible for an auditor to keep an appointment, the auditor should first contact his/her supervisor in the possibility that another auditor may be able to keep the appointment. If no other auditor is available, the appointment should be rescheduled and reconfirmed as soon as possible. If the taxpayer cancels the audit appointment, a letter should be obtained stating the reasons for the delay. If this is not possible the auditor should make a notation of the cancellation on the EDC-5. A new appointment should be scheduled immediately.

- After all preliminary research has been completed the auditor should contact the taxpayer to schedule an opening conference. The auditor needs to establish a conference within a reasonable time frame. The RAS or ADM may need to be involved in this conference also. If this conference must be scheduled at a far future date, the auditor must document the reasons as to why the conference could not be sooner.

  Example: Audit gets assigned on February 3, 2017. On February 10, 2017, the auditor schedules the opening conference for November 17, 2017. The auditor must document why this conference was scheduled in November and not sooner.

B. AUDIT INITIATION LETTER (EDA-135)

The audit initiation letter generated from GenTax, which not only confirms the appointment, but also requests documentation necessary for the audit **is required.** The language within each initiation letter will vary depending on the information needed for that particular audit.

See Exhibit E – How to create the EDA-135.

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Once an audit has been assigned, the auditor has **15** days to issue an audit initiation letter (EDA-135).

1. Letter Confidentiality

When issuing an audit initiation letter in GenTax, it is important to maintain taxpayer confidentiality, especially when dealing with a status of "married filing separately". GenTax allows for the creation of letters that will be sent only to the spouse being audited. On the GenTax letters input screen, there is a check box entitled "Include Secondary Info".

- If the taxpayer status is "married filing separately", this check box should not be checked to ensure that taxpayer information is not mistakenly provided to the other spouse.
- If the taxpayer status is "married filing jointly", this check box should be checked to ensure that both names appear on the letter.

The check box can be found on the bottom of the input screen as follow:

For additional information on confidentiality, see Chapter 1 of the Audit Manual.

2. Carbon Copy Letter Option

It is possible to create a "carbon copy" of a letter, meaning that an extra copy of a specific letter can be sent to a taxpayer that is not the original recipient. A "carbon copy" can be generated through the *View Letter Detail* window by clicking on the Letter ID hyperlink of the letter that a carbon copy is needed for.

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From the Letter Detail window that opens, click the “Carbon Copy” tab.

The “Carbon Copy” detail window will appear. To generate a carbon copy of the letter to send to a different taxpayer, click the “Add” tab.

At the “Select Level” window (previously selected addresses will appear in the table), choose the taxpayer that should be added as a Carbon Copy recipient. If this taxpayer does not automatically appear, use the green filtering field to search.

Once the correct taxpayer is chosen, it will populate in the Carbon Copy detail window.

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This Carbon Copy detail window above has four hyperlink options - *Select*, *Linked*, *Manual* and *Remove*. Click *Select* to select another address already associated with the customer; Click *Linked* to select an address for a linked customer; Click *Manual* to add a name and address for the carbon copy manually; and Click *Remove* to remove the selected taxpayer. If the correct taxpayer has populated the address block, click the box corresponding to that taxpayer recipient, then click the "OK" button.

This screen appears, allowing for the letter to be saved. Click the "Save" button to save.

The taxpayer carbon copy recipient will appear in the letter detail window under the "Carbon Copies" list section. From the letter detail window, the letter may also be manually printed (which will exclude it from being sent to the batch), invalidated, and viewed by clicking the corresponding header hyperlinks.

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3. Audit Activity Indicators and Informational Transactions

Depending on the stage that the audit is in, different activity indicators will apply. These audit indicators are an automatic function within GenTax and do not have to be manually entered. Since these indicators cannot be deleted out of GenTax, they act as a "trail" to show the timeline of the audit progress.

- Whenever an audit is set up by Audit Planning, the audit will be assigned to a supervisor for distribution to his/her audit staff. Once a supervisor assigns that audit, the indicators "Audit in Progress" and "Period Audited" will be displayed in GenTax.

- When the auditor generates an Audit Initiation letter to the taxpayer through GenTax, the "Audit Initiation" indicator will be placed on the account and an Inf-Aud Initiation transaction will appear in each period of the audit in the transactions list. It is this transaction that drives the audit late payment penalty (first 5%).

- If the audit needs to be expanded to incorporate additional years, an "Audit Expansion" indicator would appear when the additional years are added to the audit.

Audit indicators provide a history of the audit activities for the period(s) on which an audit has been set up. This history can be viewed by anyone needing audit information pertaining to that particular taxpayer.

C. GREAT LAKES STATES QUESTIONNAIRE

On July 16, 1986, the Great Lakes States of Illinois, Indiana, Michigan, Minnesota and Ohio executed the Great Lakes States Compact. One of the purposes of the compact is for the states to work together in cooperative enforcement efforts, exchanging information, etc. to obtain improved compliance by retailers and consumers in reporting sales/use taxes. Also, other states have entered into addendum agreements with the Great Lakes states for tax compliance cooperation.

Form IDR-829

Form IDR-829, Great Lakes and Midwestern States Questionnaire, was developed and agreed upon by the states. The following guidelines are in effect for all sales/use tax and income tax audits on taxpayers operating in one or more of the Great Lakes States.

- available as an Excel spreadsheet in the Standardized Forms Folder found on audit staff's computers.
- includes questions relating to both sales/use tax and corporate income/franchise tax.

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- is mailed to the taxpayer along with instructions at the same time the audit initiation letter is mailed.
    - In the case of a unitary audit, a questionnaire is sent for each corporation which apportions income to Illinois as a result of the combined return.
    - At the opening conference, the completed questionnaire(s) should be reviewed with the taxpayer's representative for accuracy. If the questionnaire(s) is not completed the information should be requested again at this time.

D. INFORMATION DOCUMENT REQUESTS & DOCUMENTING TAXPAYER MEETINGS

Nothing is more central to the audit process than the quality of the evidence the auditor has available to verify the taxpayer's various assertions as to the correctness of their filings. This is why it is necessary to thoroughly document all requests for documents or any failure of the taxpayer to provide sufficient evidence. The documentation will show that the audit has been conducted with due care and that basic audit standards have been met.

One type of evidence is documentary evidence. Documentary evidence is also known as direct evidence. It is information which is printed or written, such as: contracts, books and records, deeds, notes, tax returns, correspondence, workpapers, and photographs. **Documentary evidence is usually preferred over oral testimony** and should be obtained whenever possible. Something written at the time of the event is usually more reliable than someone's memory long after the event occurred.

Information Document Requests (IDRs) are to be used every time additional documentation is needed from the taxpayer after the Initiation letter has been sent. The Initiation letter serves as the first document request of the audit. Additional IDRs include the following documents; EDA-70, EDA-11-A, and Subpoena Duces Tecum. These forms should be used in this order of progression to keep a record of the audit and to keep the audit moving efficiently.

Documenting Taxpayer Meetings

Whenever a meeting or discussion occurs with the taxpayer regarding audit matters, a written summary of the discussion must be provided to the taxpayer’s representative. This is to document the issues discussed to ensure that both parties have the same understanding.

a) EDC-5 Audit History Worksheet

EDC-5, Audit History Worksheet is required in all audits to document important contacts with the taxpayer. This generally refers to all meetings

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and conferences specifically called to discuss any or all issues of the audit with the taxpayer, representatives of the taxpayer, audit supervisors or other Department employees. This includes the initial and exit interviews, all phone calls and conversations with the taxpayer, and all conversations with supervisors, Technical Support or other Department units about the audit. Every IDR issued, EDA-70, EDA-11-A or subpoena, must be documented in the EDC-5. **The EDC-5 must be typed.**

When documenting contacts in the EDC-5, be sure to refer to the written summary provided to the taxpayer. Document audit work performed on a daily basis on the EDC-5. On audits where lack of cooperation from the taxpayer is encountered or when the audit methodology and results will probably be disagreed to, document work performed as a means to provide for clarification at a later date.

b) EDA-70 Information Document Request

The EDA-70, Information Document Request, is required to be issued in every audit. This form documents the items that have been requested and the taxpayer's response. If after presenting the taxpayer with the EDA-70 on two separate occasions and the taxpayer does not respond, the next request to be issued is the EDA-11-A, a Notice of Demand for Books and Records.

For example, the auditor requests to see the depreciation schedule and fixed asset invoices. This information is presented to the taxpayer on the EDA-70. The taxpayer provides the fixed asset invoices, but not the depreciation schedule, so the auditor issues a second EDA-70 requesting the depreciation schedule. If the taxpayer does not comply, the auditor is required to issue the EDA-11-A.

The EDA-70 can be accessed as a savable, printable pdf on the Departments' Intranet (sp●IDOR web) under Work Areas, Audit, Forms, Universal.

c) EDA-11-A Notice of Demand for Books and Records

The EDA-11-A is a Notice of Demand for Books and Records. Unlike the EDA-70, the EDA-11-A specifies a deadline date for the books and records and the signature of the Revenue Audit Supervisor is required. The deadline is 30 days from the date the request is issued to the taxpayer. The EDA-11-A is available as a savable fill-in pdf in Forms, Universal under the Audit Work Area on the sp●IDOR web.

d) Subpoena Duces Tecum

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The final document request to be issued to the taxpayer when they refuse to provide books and records is the Subpoena Duces Tecum. A duces tecum is a subpoena requiring a party to appear in court with documentary evidence that will be inspected by the court. 35 ILCS 120/10 gives any officer or employee, designated in writing by the Director, the authority to issue subpoenas requiring attendance by a witness or to issue Subpoena Duces Tecum requiring the production of books, papers, records or other memoranda bearing on such matters that auditors have the authority to investigate. The Department has taken the position this authority extends to computer data and other magnetic media.

Subpoenas will only be issued when the taxpayer has ignored the previously issued EDA-70 and EDA-11-A. Therefore, every effort should be made to secure testimony and/or information without a subpoena. However, if there is no response to a written demand within a reasonable period of time, the audit supervisor should refer the case to the Assistant Division Manager recommending issuance of a subpoena. Where the CAA staff has been involved in attempting to secure information, they should be consulted regarding the recommendation to issue a subpoena.

Since enforcement of the subpoena can be critical to the examination of tax liabilities, it is important that proper procedural steps are carefully followed. Subpoenas will not be issued for federal tax returns, other state tax returns, 10-K statements, annual reports, or similar materials which are available from other sources. Subpoenas may be issued to compel relevant and material testimony and/or other data including computer records and tapes.

To be successful in court, the Department must show that the taxpayer refused to comply with previous requests for information. The auditor must retain copies of any written requests setting forth the specific records required. The auditor must also maintain a record of the dates the requests were made, the name of the person contacted, and notes as to whether or not compliance was secured.

If you need to issue the formal subpoena, contact the IT Technical Support Supervisor. The formal subpoena has to be reviewed by IT Technical Support and receive approval from the Legal Services Division. When requesting this form the following is required:

- Copies of the EDA-135, all EDA-70s, EDA-11-As and any other document requests.
- EDC-5 Audit History Worksheet.
- Complete details of Books and Records being requested.
- Name and address of where the form will be sent.
- Date that the documents are to be presented, 4 weeks out due to certified mail.

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The subpoena form will be completed initially by the IT Technical Support Section (only until the form is available as a fill in form), reviewed by the Technical Support Section, reviewed and approved by Legal Services, signed by the Division Manager, notarized and mailed by the IT Technical Support Supervisor. The Auditor will receive a scanned copy for the audit file when the form is sent.

E. FORM FOR SUMMARIZING TAXPAYER MEETINGS – EDA-156

In response to the release of the Taxpayer Meeting Documentation AMU (incorporated in D. above), one of the field auditors developed a fill-in pdf template to summarize meetings with taxpayers. Intent is to include this template on the sp●IDOR web under Work Area Audit/Forms, but until approved for posting, the pdf template can be obtained through the ITAPTS Supervisor.

See Exhibit R – Template for Summarization of Taxpayer Meetings

F. FREE FORM LETTER (IDOR8FF)

The IDOR8FF free form letter is used in place of the IDOR20A letter. **Exception**: Automated Audits/Projects run with the Discovery and Lead Managers.

While in the Audit View, this letter can be accessed in the Letters sub-tab under the CRM Tab. Click on the Add tab to view this letter in the audit letters listing.

Click on the IDOR8FF blue hyperlink in the *Type* column.

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The user will see this entry screen when accessing the letter. The user enters the data in the custom text box as it should appear in the letter.

Preview the letter prior to saving to be sure it looks correct and professional. Once the letter is saved it cannot be edited. If a mistake is found after the user saves it, then a new letter must be created. Be sure to invalidate the incorrect letter.

Reminder: This letter is not to be used as a substitute for the GenTax required letters such as the Initiation or Completion letters.

Do not use this letter to confirm conversations with the taxpayer concerning **proprietary information**. An example would be the following: at the conclusion of a plant tour, do not use this form to detail your understanding of the taxpayers manufacturing operation. This information should be placed in a private memo generated outside of GenTax.

G. AUDIT EXPANSION LETTER (EDA-136)

1. Audit Expansion Guidelines

Before an audit is expanded and an expansion letter sent to the taxpayer, certain issues must be reviewed in making the determination to expand the audit.

1) Timing – not to expand the audit too soon as there may be a need to wait until the original return is processed.
2) Open work items – how old are these work items? Do they need to be addressed?
3) ICB notices issued – if these have already been issued to the taxpayer, there should be no expansion of the present audit.
4) Supervisor (RAS) approval – has the request for audit expansion been discussed and approved by the RAS.

2. EDA-136 Letter Generation

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If the audit period is expanded after the audit initiation letter has been sent, an audit expansion letter will also need to be sent to the taxpayer. While in the Audit View, this letter can be accessed in the Letters sub-tab under the CRM Tab. Click on the Add tab to view this letter in the audit letters listing.

Click on the EDA136 blue hyperlink in the *Type* column.

Previously users could choose whether the verbiage would say notified of the extended audit period by phone or by the letter. Users can now also choose to have the letter reference that the taxpayer was notified in person (meeting) of the extension of the audit period. The input screen follows:

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Complete the Input screen with the necessary information, which includes the additional period(s) being added. After reviewing the letter for accuracy (Preview Letter), save and then print the letter.

H. SELECTING TEST METHODS AND PERIODS

Some type of sampling method may be used to complete an audit. This provides an economical and reasonable method to verify the accuracy of a large number of transactions.

Before a sampling method is selected, the Auditor and Computer Assisted Audit (CAA) staff should make a proper study and evaluation of the taxpayer's business activities and records. The Auditor must establish a basis for selecting the sampling method to be used in the audit. The population of transactions to be reviewed in the audit must be clearly defined before any method is selected. The population that is defined will help to determine the method to select.

Once the study and the definition are completed, the Auditor is ready to select the audit method to be used. The method selected must be defendable as the best method available under the circumstances. Thus, it will be necessary to document the method used to determine the population and selected audit technique. Included in this description should be the reasoning and methodology used to select the sample units or periods.

In some instances, a detailed examination of the population will be the best method. One example of a detailed audit would be one in which the population is small, and the review of documents is easy and readily accessible. When CAA techniques are used, the Auditor may be able to accurately pinpoint the audit exceptions. In most audit situations, the detailed examination of an audit population is not feasible and should be avoided. This is not to say that a detailed review of large dollar invoices in stratified sampling should be ignored. This is a proper and necessary part of many sampling techniques.

1. Computer Assisted Audit (CAA)

The Audit Bureau's position is that statistical sampling is the preferred method in large case auditing. Computer Assisted Audit techniques (CAA) will be used in these instances. **The auditor should contact CAA personnel on these cases as soon as the case is assigned.** CAA staff will be able to discuss the information with the taxpayer to determine the proper way to proceed. CAA personnel may be able to secure the data necessary to perform the audit prior to the first audit appointment. In these instances, the auditor may walk into the taxpayer's business with reports in hand. This is not to say that CAA cannot be considered for medium-sized cases. If the taxpayer has a large volume of

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transactions or the case took a large number of hours in the prior cycle, these cases are prime targets for CAA techniques.

To request CAA assistance, the auditor should complete and submit the form – “Request for Services of Computer Assisted Audit Group” as shown below. Submission should be through the auditor’s immediate supervisor. This form (marked “Request New”) is found in: (1) the CAA folder within the Standardized Forms folder on field staff laptops, or (2) on (C:) Drive in the CAA folder within the Forms folder for in-house staff using desktop computers.

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ILLINOIS DEPARTMENT OF REVENUE
Audit Bureau
Computer Assisted Audit Group

REQUEST FOR SERVICES OF COMPUTER ASSISTED AUDIT GROUP

PART I – TO BE COMPUTED BY REQUESTER Date: _____

Requester's Name: _____ Requester's Phone: _____

Requester's Supervisor: _____ Office/Unit: _____

Taxpayer or Project Name: _____ Audit Period: _____

Contact Person's Name: _____ T.P. ID No.: _____

Contact Person's Email ID: _____ Contact Phone: _____

Taxpayer Mailing Address: _____

City: _____ State: _____ Zip: _____

Nature of Assistance Requested (Check all that are applicable)
☐ Audit ☐ Statistical Sampling ☐ Other (Specify): _____

Taxes Involved: ☐ ROT/UT ☐ CIT (Specify) _____ ☐ WIT ☐ IIT ☐ Other: _____

Has the CAA Group been involved in a previous audit cycle? ☐ YES ☐ NO

Provide information relating to prior cycle, Track Number: _____ ID Number: _____

Audit Period: _____ Tax Adjustment: $ _____ Hours: _____

Explain nature of request: (Attach additional pages if needed)
Requesting CAA for ☐ Sales ☐ Payables ☐ Credits – Specify _____

☐ Other – Specify _____

If prior audit was CAA, you are not required to complete the remainder of the form, unless additional information regarding changes in business are known (add/close locations, changes in product line, etc).

Estimated Number of Transactions or Boxes of Transactions per Month Sales _____ Payables _____

☐ Transactions ☐ Boxes Credits _____ Taxable Sales % _____

Describe Business Operations (Retail, Manufacturing, Number of Locations/Divisions, etc.)

Other beneficial information such as: expansions, mergers, reductions, electronic commerce activities, etc.
Additional information regarding CIT requests. Information regarding other requests such as in-house projects.

Part II – To be completed by CAAG
☐ Accepted ☐ Not Accepted ☐ Not Required ☐ Other _____ Date: _____

Explanations: _____

CAA Track#: _____ Project#: _____

Areas of Potential Use

The list below is intended to provide some potential areas that CAA may be able to assist with in conducting CIT audits. This list is not intended to be all-inclusive but is provided to give ideas of potential areas where CAA can benefit the audit process.

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Potential Use	CAA Activities that may be Employed
US Gov't Interest	Identify file-containing data supporting subtraction. Summarize type of obligations claimed with dollar totals and record counts.
Credits – Replacement Tax Investment, Training Expense, and Enterprise Zone Investment	Identify file-containing data used to calculate credit. Summarize names, products, etc. utilized to calculate credit with record counts and dollars. Once population built, stratify and sample the population. CAA evaluation of sample results provides information necessary to calculate sample adjustment. This could be done with the recapture of certain credits.
Sales Factor	Obtain file containing sales transactions summarized in order necessary to identify the proper calculation of the factor. Summarize data in file and provide correct amounts for the factor.
Property Factor	Depending on area wanting to work on we have had some success in this area. Normally large companies maintain a Fixed Asset Management System file that is created for the IRS that contains the necessary information.
IL-1023C Partnership Test	Review of 1023C filers for accuracy based on information pulled from Gentax. This is also useful in reviewing S-Corp shareholders for non-filing of Illinois returns. List of shareholders SSNs can be matched against IDOR income tax files to identify missing periods. NOTE: With the implementation of Gentax, information on partners/shareholders may be accessed from not only the IL-1023C but also from the IL-1120-ST and IL-1065 (Schedule B information). Currently, no information can be "downloaded" from the IL-1000.
Filer Verification	Review of companies listed on US Form 851, US Form 7004 or other source to verify who is in the Gentax system as a filer. This is useful in verifying that we do not miss a company for waiver purposes. Also, may be able to use as a replacement for the AUB schedule.
Consolidated Group File	This file may be in Excel or Corp Tax for example. This should contain all consolidating information for all members of the Federal consolidated group. This should allow for assistance and speed in determining the impact of adding or removing companies from unitary groupings.

Even if a statistical sample is not used in the audit, CAA should still be contacted for advice on the sampling method that the auditor may want to employ.

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2. Projecting Prior Audit Results

A considerable amount of audit hours can be saved when prior audit results are utilized as the basis for the current audit liability. The following guidelines will serve as a basis for the minimum amount of fieldwork necessary if prior audit results are to be utilized.

a) Audit History

When an assignment is received, review the Continuing Audit File (CAF) to develop an idea as to the issues contained in the prior audit. If necessary, secure the prior audit file. Analyze how the samples were prepared and whether they were sufficiently valid to warrant utilization in the current audit. If there are doubts as to accuracy and validity of prior audit results, the Auditor should not pursue this approach.

b) Management Approval

It is mandatory that Management participates in any decision-making on cases utilizing prior audit results. Approval of the audit supervisor is required and must be documented.

After an error rate projection is made based on the prior audit results, any subsequent audit periods may only be projected with the written approval of the Assistant Division Manager.

Only AGREED audits can be processed when this method is used.

c) Taxpayer Interview

Conduct an on-site interview with the taxpayer where applicable (field staff audits). An interview over the phone will not be acceptable. An in-state plant/facility tour could also prove helpful. Interview a responsible officer of the company and obtain information on operational changes, changes in product line, and any mergers or acquisitions that may have occurred. Interview the responsible tax return preparer, especially when there has been a change in personnel. You may elect not to proceed if there have been significant changes in the business since the prior audit.

d) If CAA Was Used in the Prior Audit

The CAA staff needs to be contacted if the prior audit utilized CAA and the Auditor is considering using the prior audit results in the current

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audit. It will be necessary to obtain the taxpayer's computer records to recreate the same populations that were used in the prior CAA samples. CAA will provide reports to ensure that any changes in locations, cost centers or accounts can be addressed. If any new changes exist from the prior audit, separate audit procedures may need to be utilized depending upon their significance.

CAA will recreate the population that was utilized in the prior cycle. The newly created population will be stratified on the same basis as the prior cycle. This should be compared to the stratification report from the prior audit to determine if any significant changes exist between the two periods. If the dollar difference between any stratum or the total population is significant, further analysis will be necessary to determine the viability of an error rate projection.

If the prior audit result projections are used, then the detail stratum from the prior audit needs to be analyzed to determine how it will be addressed. There are two options that exist for the detail stratum:

1) review the new period in detail; or
2) use a percentage of error projection based on the prior audit.

A comparison of the detail stratum for each period will need to be performed to determine the proper method to employ. If the strata contain significant differences, then the Auditor should consider a detail review of the new period's stratum.

If the transactional makeup of the strata is substantially the same, then an error rate projection should be considered. The remaining sample strata would be projected based on the percentage of error for each stratum from the prior audit applied to the new period dollars.

If a stratum in the prior audit was un-projectable due to the number of exceptions found, then the Auditor should either propose no additional tax due for the stratum in this audit cycle or a sample may be drawn on this stratum for the new period.

If an area of small dollars were not sampled in the prior audit cycle due to immateriality, then they will be ignored for the new cycle as well.

VI. ATTENDING INITIAL TAXPAYER CONFERENCE

The initial meeting with the taxpayer can have a significant impact on the entire information gathering process of the audit. A well-prepared auditor is more apt to obtain

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the information necessary for completing the audit than one whom the taxpayer feels is unprepared.

During this opening conference, the taxpayer should be informed that:

- any outstanding (unpaid) assessments, for all tax types, will need to be addressed. The **Statement of Customer** available in GenTax should be utilized to collect these outstanding liabilities (see "Statement of Customer" Section A that follows below for instructions).

- a compliance check of the business (unless unitary) and the owners (partners, shareholders, etc.) for all taxes administered by the Department (Income, Sales, Withholding, etc.) is a required part of the audit.

The opening conference discussion should include:

- audit scope
- documents required
  - As part of the audit process, some auditors had begun asking to review FIN 48 workpapers (considered by the IRS as tax accrual workpapers) on a routine basis. However, such a review does not reflect the Department's current policy. The audit staff should not ask for or review these FIN 48 workpapers as part of the audit.

- estimated timeframes needed to complete various audit phases. By establishing timeframes within the audit, keeping scheduled appointments with the taxpayer becomes a high priority.
  - Once each audit phase is completed, the taxpayer should be provided with schedules (and discussion if needed) outlining the proposed adjustments. If the audit is not completed during the initial appointment, the auditor and taxpayer should meet to discuss any phases completed, extra documentation that may be required, and the timeframe for resuming the audit.

A. STATEMENT OF CUSTOMER – COLLECTION OF ASSESSMENTS

Auditors are responsible for advising a taxpayer of any outstanding liabilities and attempting to collect any balance determined to be due during the course of completing their audit. The following sections will provide information and guidelines on how to handle outstanding assessments that exist for taxpayers under audit.

NOTE: Before generating the Statement of Customer, it is important to research the taxpayer for any outstanding balance(s) that have gone to an **outside collection agency** (OCA). GenTax will be checked for Collection information as follows:

1) Access the taxpayer through the Search Manager by entering the FEIN or SSN dependent on that particular taxpayer.

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2) Click on the “View Additional Information” icon located in front of the taxpayer’s name, as indicated below in the red box.

3) The “additional information” box will open. If there is Collection information present indicating OCA activity (see red box below showing an IIT account), the auditor must send an email to their immediate supervisor indicating the OCA activity. The supervisor will then forward this information to the ITAPTS Supervisor for review in determining any outstanding taxpayer balance owed to the Department of Revenue. No Statement of Customer should be generated until this review process has been completed.

Verifying Outstanding Assessments and Liabilities

a) Viewing Assessments in GenTax

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The Audit Bureau requires auditors to advise a taxpayer of any outstanding liabilities and to attempt to collect these balances during the course of the audit. By clicking on the period hyperlink, the auditor can view all transactions associated with that period.

Additional information such as bill items, payments and refunds can be accessed by clicking on any of the sub-tabs that appear with the transactions.

b) Types of Statements Found in GenTax

Taxpayer Statements allow IDOR to communicate account information to taxpayers and to facilitate their payment(s) for each account that has a balance due. These taxpayer statements list liabilities and/or credits by period. Audit personnel will use taxpayer statements to communicate and solicit payment of all current liabilities owed by the taxpayer to the Department.

The Statement of Collection reflects only collection items. These statements will only be issued by collections personnel.

The Statement of Account reflects only the information specific to the selected account.

The Statement of Customer reflects information for ALL tax types. Outstanding (unpaid) assessments can be verified by reviewing the taxpayer's **Statement of Customer** in the Customer View**.** The Statement of Customer will only have entries if there is a balance. If no debt is eligible for a Statement of Customer, a box will appear stating such when the View Statement Tab is selected.

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[redacted]

The Statement of Customer is the most comprehensive tool that can be utilized to advise the taxpayer of outstanding liabilities (including updated penalty and interest) across all tax types that the taxpayer is required to file and pay. Taxpayers can be presented with a Statement of Customer and **make payment utilizing the voucher found on the bottom portion of the statement.**

c) Creating the Statement of Customer

If the auditor is successful in collecting these assessments, he or she must attach the remittance to the voucher portion of a **newly generated, updated Statement of Customer,** and forward or mail to the IDOR address shown on the voucher. The reason for not using the original unpaid assessment notice that the taxpayer may possess is that the Statement of Customer generated by the auditor includes updated penalty and interest calculations.

Note: Auditors should make a photocopy, for the audit file, of the Statement of Customer, Voucher, and taxpayer payment that is being remitted. Photocopy of these items should be scanned and saved electronically with the audit documents.

In those instances where a collection case is in process, the auditor should contact the assigned collection representative to coordinate the collection. To determine if a collection is in process, the auditor can look in the Indicators Panel to see if there is an indicator showing “Collection in Progress.” The collection representative information can be accessed through the collection hyper-link, where the name and phone number of that representative (“owner of the collection”) can be located. Additional information on this collection may also be found in the account comments. Contacting the collection representative is important because collections may have issued demand letters, bank levies, wage garnishments or liens which might have an impact on how the auditor is to proceed.

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All auditors have the authority to issue or reissue the Statement of Customer, or a Statement of Account (SOA), so that outstanding debt and assessments can be collected with updated penalty and interest. This will create a corrected voucher to send with any payments collected on outstanding assessments.

- **See Exhibit F- How to Generate an Updated Statement of Customer.**

Important Points to Note:

- Periods "under review via correspondence received" will not be included in the voucher amount. Such periods will state on the Statement of Customer that they are "under review via correspondence received" and no pending dollar amount will show for that period.
- Credits are not added to the voucher balance.
- Voucher will only reflect a balance due.
- Write-offs will be shown on the main screen but will not show on the Statement of Customer until the write-off value has been reinstated. A write-off is an amount that is owed but has been taken out of the "active" collection process. Most times a "lien" has been filed against these write-off amounts. This liability would need to be reinstated to the system for payment, including any lien release fees. Auditors would need to contact the Collection Support Supervisor directly to have these liabilities reinstated.

B. RETURN ISSUES

- If required returns outside of the audit period have not been filed, the Auditor should firmly encourage the taxpayer to prepare the missing returns and submit them before the close of the audit.

- If the taxpayer does not comply, the Auditor will initiate an additional audit and establish the liability. An SC-137 must be submitted (through the RAS) to Audit Planning to set up this audit in an email to REV.G.ITAuditPlanning@illinois.gov.

- If the taxpayer has failed to keep copies of filed returns and will be requesting copies from the Department, the taxpayer needs to fill out the IL-4506, Request for Copy of Tax Returns, and send the completed form with payment [$5 charge per return requested] to the address listed on the IL-4506. Note: Returns may have balances due which are not processed.

- If the taxpayer presents an original/amended return(s) to the auditor, the auditor needs to follow these steps:
  - Check that the return has been signed.
  - Write "Received by IDOR" on the top of the return, date and initial the return. This is very important for statutory control purposes.
  - All schedules and attachments should be provided by the taxpayer with the return. The auditor must verify that schedule information is accurate and

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that the returns correctly down foot.

- Make a copy of the return for the audit file (and/or scan and save with other audit documentation) and send the signed originals to Audit Planning (AP). AP will scan and attach the return to the audit track in GenTax, and then send the return to case files.

- If federal tax information (FTI) needs to be verified through the warehouse, the information should not be printed for the audit file. Auditors should state that the taxpayer's filings have been verified using "available IDOR resources" not the federal warehouse.

C. EMAIL AUTHORIZATION

Management encourages the use of email to communicate with taxpayers. In order to avoid potential problems with respect to the security of Email and the transmission of confidential information, the EDA-154, Audit Email Authorization, should be utilized. This form needs to be completed by the taxpayer and submitted back to the auditor. A copy of this authorization form is to be included in the completed audit report. The most current EDA-154 is available as a fill-in savable pdf, which should be saved electronically with all other documents in the electronic audit file.

Audit Email Authorization Form (EDA-154)

The EDA-154, Audit Email Authorization, is available in the Forms section under the Audit Work Area on the sp●IDOR Web (intranet). The same form is also available on the Department's website, under Forms, then Miscellaneous.

See Exhibit G - EDA-154 Audit Email Authorization.

D. IL-2848, POWER OF ATTORNEY

This information was removed from this chapter and is replaced by AMU IT18-02 (POA), which goes into Audit Manual Chapter 2.

E. IL-872, CONSENT TO EXTEND THE TIME TO ASSESS OR REFUND INCOME TAX

Form IL-872 is used to extend the statute of limitations for audit years. **It is extremely important to realize when there is a statute issue with the concern that the statute could be lost, and that Form IL-872 should be executed to extend that statute.** Under IITA § 905(f), a Notice of Deficiency may be issued at any time prior to the expiration of the period agreed upon on Form IL-872. Both the taxpayer and the

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Department must execute the extension prior to the expiration of the previous statute of limitations. See Ch 21 for more details concerning the IL-872.

Per IITA § 905(f), the IL-872 and ICB-1 are both viable vehicles to honor this statute for extension.

Auditors must include a signed copy of the IL-872 as an attachment to the Audit Springboard in GENTAX.

See Exhibit I – How to Scan and Attach a Document to an Audit in GenTax.

Faxed IL-872 forms

- A faxed IL-872 becomes effective and enforceable upon the Department's countersignature of the faxed document, IF BOTH the taxpayer and the Department have signed within the proper statutory period.

- Even though the Department will countersign a faxed waiver, it should be requested that the taxpayer forward the original waiver form to the Department. The original waiver should then be attached to the faxed waiver that has already been countersigned. Both documents should be kept in the audit file. If electronic documents are provided, paper copies are no longer required in the audit file.

F. DETERMINING THE DESIGNATED AGENT

Determining the designated agent should be done as early as possible in the audit. 86 IAC §100.5220(a) states that the designated agent must be the controlling corporation if it is a member of the combined group and has nexus in Illinois. If the controlling corporation is not an eligible member of the group, the members must choose another designated agent. The Illinois filing member with the largest consistent liability should be selected, but this is not mandatory.

For details on designated agent determination and the use of new Form IDR-229-UB, Change of Designated Agent, refer to Chapter 23.

G. EXAMINING BOOKS AND RECORDS

While most taxpayers are cooperative in providing auditors with the information necessary to perform an audit, occasionally a taxpayer who is uncooperative may be encountered. In these cases, it is important for the auditor to know his/her authority for requesting and obtaining necessary information.

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Authority to Examine Books and Records

The authority to examine a taxpayer's books and records can be found in IITA § 913. IITA § 506(a) also deals with the Department's authority to obtain information, specifically, the federal return.

a) Federal Returns

The Illinois filer can be required to furnish a copy of ANY return filed under the provisions of the IRC, which has an effect on any item reported on that company's Illinois return. In the case of a company which is a member of a federal consolidated group, the federal consolidated Form 1120 is needed in order to verify the pro forma figures and to determine if the federal pro forma income is the correct Illinois pro forma income amount. See Chapter 24 for more information on Illinois pro forma income.

b) CPA Prepared Returns

Information given by a taxpayer to a CPA is not "privileged information" and may also be requested. In late 1988, the Illinois Supreme Court ruled that no information provided to an accountant for use in the preparation of tax returns was confidential because the client understood that the accountant might disclose part or all of the information to the government by filing returns.

c) Photocopying of Information

The Department's authority to examine a taxpayer's books and records also extends to PHOTOCOPYING books and records. Failure to provide photocopies when requested or refusing to allow an auditor to use photocopying equipment, assuming reasonable requests are made, will be considered as a failure to allow inspection of books and records in violation of IITA § 913. In the case of *People v. Floom* [(1977) – 52 Ill App 3d 971.], the court held that the "**power to inspect also included the power to copy records**".

A photocopy of returns, supporting schedules and breakdowns, unitary information, and other information is necessary to properly support the audit findings. At the beginning of the audit, the procedures for photocopying this information should be discussed. If the taxpayer refuses to allow photocopies of information to be made, the request and the taxpayer's refusal should be put in writing and the formal request (and possibly subpoena procedures) should be implemented.

d) Documenting Information Reviewed in the Audit

During the course of the audit, material may be examined that is not photocopied and included in the audit file due to volume or the nature of the information. Usually

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under these circumstances, notes about such material should be made and included in the audit.

Since the documents which served as the source for these notes may be very valuable evidence if the audit is protested or litigated in court, it is essential that the material that has been examined be properly identified and summarized. The following information should, therefore, be obtained and documented:

- The name or title that appears on the report, chart, brochure, etc.
- The date it was issued.
- The number of pages.
- The place the original or master copy is kept.
- The name of the person to contact regarding the material.
- The name of the person who prepared the report and to whom it has been distributed in the company.
- A description of the contents or listing of the table of contents if available.
- If the material consists of excerpts, a list of the applicable page numbers should be identified.

Any documents received from the taxpayer should contain:

- The name of the person providing the document and the date received, and;
- The file name the taxpayer uses to identify the particular file.

This eliminates the possibility of the taxpayer, at a later date, denying that a certain report exists simply because it is being called by a title other than the one the taxpayer uses. Any information contained in the audit workpapers should be referenced to the applicable source document.

If interviews with the taxpayer, his personnel or representative have been relied upon, as soon as possible after the interview the conversation should be summarized. The summary should contain:

- the questions asked, and the answers given by the taxpayer
- the name and title of the individual(s) interviewed
- the date, time and place that the interview was conducted
- the names of other persons present at the interview.

This summary should be verified by the individual interviewed and his signature should be obtained, if at all possible.

Note: The above cannot be stressed enough since issues have come up during litigation where the Department has been asked to identify records used during an audit, but not retained.

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H. REQUESTING FEDERAL TAX INFORMATION (FTI)

Every attempt should be made to obtain federal return information in the following order:

a. From the taxpayer. Unless the taxpayer is a true non-filer, the taxpayer should be able to provide their federal return information.

b. From the Data Warehouse. The auditor needs to thoroughly research the information available in the warehouse. Field staff who does not have access to the warehouse must contact the ITAPTS supervisor for warehouse information.

- When checking records in the warehouse, need to change "Default" view from the "View 1" to see everything available in each file.
- Most often what is available in the warehouse provides more detail than a transcript will provide.

Note: Anytime that a number is taken from the Data Warehouse (Federal information) and transferred onto Audit documentation (i.e. EDA-25), it is then considered Federal Tax Information (FTI) and must be protected with a Federal folder and tracking sheet. However, if Line 1 AGI is only being verified through the Data Warehouse without printing it for an audit file, it is NOT considered FTI and does not require the folder/tracking sheet. In such a case, auditors should state that the taxpayer's filings have been verified using "available IDOR resources" not the federal warehouse.

c. From the Disclosure Officer. IRS Form 8796-A should only be completed and submitted to the disclosure officer as a last resort to obtain federal information.

- Transcripts can only be ordered for the last three years. Information often provided in a transcript does not help in an audit.
- Copies of returns can be ordered but can take a considerable amount of time (6 months is not uncommon).
- The Disclosure area is under new, more stringent IRS security measures which include new requirements in tracking the requests that are handled. On the next IRS review, it is important to show that the Department is not continually ordering transcripts for information that is already available (such as on the warehouse).

Complete information concerning FTI and Form 8796-A has been moved to Audit Manual Chapter 1.

VII. CONDUCTING THE AUDIT

This section provides a layout of steps when conducting a CIT audit. The steps would be similar for other Income Tax audits – WIT and IIT. See Audit Manual Chapter 44 for WIT and Chapter

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45 for IIT.

A. AUDIT STEPS

1. Line 1 Adjustments during an Audit

During the audit process, an auditor may make the determination that adjustments are necessary to the reported Line 1 figures on the Illinois return(s). Dependent on the type of audit, this would include:

1) Federal taxable income – IL-1120 and IL-1041
2) Ordinary income – IL-1065 and IL-1120-ST
3) Adjusted gross income (AGI) – IL-1040

Audit policy now dictates a new procedure that instructs auditors that they **must** submit a request for Illinois Line 1 change approval. This approval must be submitted through the auditor's supervisor, who will then forward the request to the Income Tax Audit Planning and Technical Support (ITAPTS) supervisor. Appropriate supporting documentation must be provided with the Line 1 adjustment request at the time of submission.

When submitting such a request, proper statute control procedures **must** be followed. Submission of a Line 1 change request needs to be made as early as possible in the audit. If needed, a properly executed IL-872 must be on file to support the time required for approval. Reminder: Per Management Expectations, audits are required to be sent to Audit Review with a minimum of 60 days left on the statute.

Audit changes made based on the federal tape match information are not affected by this policy. Also, not at issue would be when auditors question federal items that only affect items other than Line 1, such as modifications, apportionment or credits. Additionally, Line 1 changes necessary due to additions/deletions of UBG members would not be affected by this policy.

2. Audit Issues

When the auditor attends the initial meeting with the taxpayer, the following should have already been determined:

- Column A figures to be used in the audit
- The statute date and the possible need for a signed IL-872 extending the statute of limitations.

During the taxpayer conference(s), the audit issues need to be addressed with the taxpayer. The auditor will need to complete the appropriate schedule(s) within the Audit CIT package (DAN or APT – see note that follows), and also update the auditor comments on the issue.

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Note: Effective 8/3/2015, any audit that is in progress but has NOT had an ICB notice (EDA-122, 124 or 125) issued should be completed using the CIT package (APT). One exception is if the number of hours already spent on the audit is too great that re-entering data into APT would be inefficient for completion of the audit, it may be completed in DAN but ONLY with Supervisor and ADM approval.

Currently, APT can be used in IL-1120, IL-1120-ST and IL-1065 audits. The following chart shows the forms, documents and work papers programmed in APT for the IL-1120, IL-1120-ST and IL-1065. These self-contained APT forms, documents and work papers should only be used when completing APT audits, as opposed to using previous standalone work papers in these audits. Included are the forms now available in the APT Bundle. The “X” indicates what is available for each audit type (1120, 1065, and 1120-ST).

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APT Forms, Docs and Workpapers			
	IL-1120	IL-1065	IL-1120-ST
Form	EDA-25	EDA-92	EDA-93
Docs			
EDA-51	X	X	X
PROD-1	X	X	X
EDA-8-A	X	X	X
EDC-5	X	X	X
Required Work Papers			
IL-4562	X	X	X
EDA-27	X	X	X
Schedule M	X	X	X
Schedule 80/20	X	X	X
Schedule 1299-D	X		
Other Work Papers			
IL-477	X	X	X
Schedule 4255	X	X	X
Schedule N/B	X	X	X
Schedule 1299-A		X	X
Schedule 1299-B	X		
Schedule J	X		
Income Reconciliation Worksheet	X		
Loss Reduction Worksheet	X		X
Bundle			
1120, 1065, 1120ST			
132-UB-R0116	X		
EDA-130	X		
EDA-25 Standalones	X		
IDR-229-UB	X		
Insurance Co- Only	X		
EDA-92 Standalones		X	
Investment Prtn Test WS		X	
EDA-93 Standalones			X
Shared			
Cxilloss	X	X	X
EDA-70 IDR	X	X	X
IL-872	X	X	X
Bonus Deprec Sep Yrs	X	X	X

NOTE: Currently, there are instances when APT cannot be used in an audit:

- Two or more Separate Unitary Business Groups (UBGs) to one combined UBG. Example: UBG with three members being combined with another UBG with 5 members.

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- Two returns filed with the same year end. Example: Returns filed for 5/31/2015 and 12/31/2015.
- Returns with UB INS through 12/31/2011.
- Separate Unitary filer. Example: UBG with members that file different return types – 1120, 1065, 11120ST.

The chart below lists audit issues and the audit manual chapter that relates to that issue.

AUDIT ISSUES	AUDIT MANUAL CHAPTER
Unitary Business Income	Chapter 23
Combine As-Filed Calculation	Chapter 24
Addition Modifications	Chapter 24
Foreign Dividend J	Chapter 25
Subtraction Modifications	Chapter 25
Nonbusiness Income	Chapter 26
Sales Everywhere	Chapter 27
Sales Illinois	Chapter 27
Partnership Income	Chapter 28
UB-INS (For Insurance Audits Only)	Chapter 31
Federal Net Loss subtraction	Chapter 35
IL Net Loss Deduction	Chapter 35
ILNLD Supporting Schedule	Chapter 35
Investments Tax Credit Recapture	Chapter 36
RT Investment Tax Credit	Chapter 36
IT Investment Tax Credit	Chapter 36

Federal NOL or Illinois NLD

In audits where the taxpayer is claiming federal net operating losses or Illinois net loss carryovers, the Auditor is required to verify the loss carry over. This verification should include:

- a detailed analysis of the audited losses and how/where these are to be carried
- complete NLD schedules to ensure that the NLD screen in GenTax reflects the correct application of losses for the years in the audit and all prior years
- all schedules and workpapers generated in that verification process

All loss verification documentation must be included in the audit file. It is important that losses have been verified in order to quickly and accurately see what/if any losses are available to carry forward.

For tax years ending on or after December 31, 2014, the $100,000 limitation on the use of Illinois net loss deduction (NLD) has expired. When

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determining the years to which a loss can be carried forward for corporations, do not count:

- tax years ending after December 31, 2010, and before December 31, 2012;
- the taxable years for which the deduction would exceed the $100,000 if not for the NLD limitation (tax years ending on or after December 31, 2012, and before December 31, 2014).

3. Offsets

All offset requests from the taxpayer must be in writing.

There are specific protocol that address how to do offsets between audit periods, outside of audit periods, and between tax types. Proper chain of command approval must be followed dependent on the type of offset requested. Chain of command entails the following order:

- Revenue Audit Supervisor (RAS)
- Assistant Division Manager (ADM) – [if applicable]
- Division Manager (DM)
- Program Administrator (PA) [This is the Bureau Manager]
- The Director of Revenue [if required]

a) Within the Audit Period

- Offsets within an audit for the same taxpayer within the audit period can be approved by the RAS.

- Offsets between taxpayers within the same FEDERAL consolidated group, but for IL purposes must file in different groups, can request offset within the same audit period. This type of offset can only be approved by the Division Manager. Auditor needs to submit this request through his/her RAS.

b) Outside the Audit Period

- Offsets requested to have money offset to a period outside of the audited periods must go through the Program Administrator for approval by the Director. Auditor needs to submit this request through his/her RAS. This applies to both dot point situations in a) above – same taxpayer, and taxpayers within the same federal consolidated group filing in different groups for Illinois purposes.

a) Unrelated taxpayer or unrelated tax type

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- Offsets requested to unrelated taxpayers or unrelated tax types must be go through the Program Administrator for approval by the Director. Auditor needs to submit this request through his/her RAS.

4. Audit Determination

Once the audit issues have been addressed, the determination may fall in one of three categories:

- Taxpayer agrees with the audit findings (Agreed)
- Taxpayer does not agree with the audit findings (Unagreed)
- Taxpayer agrees on some issues, but not on others (Both)

B. BACKING UP IN-PROGRESS AUDITS

In order to minimize any potential loss or corruption of computer data, auditors are responsible for following an appropriate system backup routine for their "current" audit. While certain tax programs have incorporated automated backup routines and reminders each time they are used, users still need to be conscious of performing regular backups to all critical information.

A general guideline would be once a day. However, to be safe, anytime that a substantial amount of work is completed in a tax program (or other software program) this information should be backed up. As important as recognizing the need to backup this information, guidelines must be followed regarding the storage location of this saved data.

1. Computer Hard Drive

Field: In-progress audits should always be backed up on the auditor's computer hard drive.

In-house: In-progress audits should always be backed up on the auditor's H:\ drive.

2. Flash Drive - Field

An encrypted flash drive issued by the Department is the most logical source of "local" backup in addition to the hard drive. However, it is imperative that the flash drive not be stored with your computer. This way in case the computer/data is lost, stolen, damaged, etc., the flash drive will not be affected. Keeping the flash drive in your computer bag will defeat your efforts! This is your only protection if you lose the information stored in the computer's hard drive.

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VIII. TECHNICAL SUPPORT GUIDANCE

This information has been moved to Audit Manual Chapter 2.

IX. TECHNICAL REQUEST PROCEDURES

This information has been moved to Audit Manual Chapter 2.

X. DOCUMENTATION NEEDED IN COMPLETING AN AUDIT

This section provides detailed information about the main documentation that is required when completing an audit. Although only certain required documents are discussed, other documentation may be required as listed on the EDA-51, Income Tax Audit Index. This section does not include a discussion of all audit documentation as seen on the EDA-51.

A. AUDITORS REPORT

Auditor's Reports are referenced as follows:
EDA-24 Individuals
EDA-25 Corporations
EDA-26 Fiduciary
EDA-92 Partnerships
EDA-93 S-Corporations
EDA-127 IL-1023-C – available in the CIT Standalone

The following discussion is primarily directed toward corporate audits; however, many of the same procedures apply to other, non-corporate, Income Tax audits. Refer to Chapter 28 for more information regarding non-corporate Income Tax audit procedures.

EDA-25

For audits completed outside of the APT program, the EDA-25 should be accessed in the CIT Standalone package. For audits completed in APT, the self-contained APT EDA-25 should be used.

The Column A, As Filed, amounts on the EDA-25 should reflect the actual tax assessed to date. The current amounts may be from the original return, amended returns, math error adjustments, previous audits, or legal settlements. Column A, As Filed figures typically must include the last adjustments posted in GenTax for each APE within the audit period, unless an exception as discussed in these procedures applies.

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- If the return can't be viewed in GenTax, then the auditor must check to see if the return information can be viewed in Legacy PDF Display. Legacy PDF Display contains all of the information that was previously in the Mainframe/Legacy system (and then IRIS) that was used by the Department prior to GenTax. The information in Legacy PDF Display was last updated November 2007 prior to conversion to GenTax which was in December 2007.

- If the return is in GenTax, the most current account information will be available in GenTax. If the return in GenTax has converted credits, Legacy PDF Display information can be used to see the payment detail that may not be available in GenTax.

- For audits completed in APT, the self-contained EDA-25 should be utilized. APT is designed for the auditor to complete multiple Auditor (EDA) reports for each year of the audit when warranted. In circumstances such as math error corrections, amended returns, etc., which all must be resolved prior to or as part of the audit, the auditor will be able to access different versions of the report to make the necessary changes. See the APT Reference Guide in the Audit Training Section under *Work Areas* on the Intranet for detailed instructions on EDA-25 completion.

  ✓ See Section IV.C. for additional information on Column A determination.

a) Completing the EDA-25 When There Is an IL-1120-X That Has Not Been Processed

(1) Underpayment

If an IL-1120-X reporting an underpayment has been filed and has not yet been processed, the figures on the IL-1120-X would not appear on GenTax. However, the IL-1120-X underpayment is an admitted liability, and the IL-1120-X should be processed before any audit adjustments.

- The IL-1120-X, Column A, needs to be verified with GenTax. If the figures in Column A of the IL-1120-X agree with the figures on GenTax then Column C of the IL-1120-X needs to be used for the EDA-25, Column A that the auditor is preparing. Column B of the EDA-25 will represent the audit adjustments and Column C will show the corrected audit results.

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It is important to remember that the statute of limitations for issuing a Notice and Demand on an admitted liability expires 3 years after the date the amended return is filed and cannot be extended with a waiver.

(2) Overpayment

If an IL-1120-X has been filed claiming an overpayment and has not yet been processed, the IL-1120-X adjustments will not appear on GenTax. However, unless the IL-1120-X is withdrawn in full, it must either be allowed, or partially or fully denied.

- The IL-1120-X, Column A, needs to be verified with GenTax. If the figures in Column A of the IL-1120-X agree with the figures on GenTax then Column C of the IL-1120-X needs to be used for the EDA-25, Column A that the auditor is preparing. Column B of the EDA-25 will represent the audit adjustments and Column C will show the corrected audit results.
  - In a situation where the auditor is denying a portion of the claim, the auditor must complete an EDA-25 where Column A will typically be taken from GenTax and Column B will reflect the claim adjustment that is being allowed. The appropriate language must be shown on the IL-870 regarding the partial denial, if unagreed. For audits completed in APT, the IL-870 is no longer used.
  - In a situation where the auditor is denying the entire claim and there are audit adjustments for the same year, the auditor will complete an EDA-25 and Column A will typically be taken from GenTax.

The above instructions are for processable IL-1120-Xs (i.e. Column A of the IL-1120-X agrees with GenTax).

- If the IL-1120-X is not processable then the auditor should refer to section~~s~~ "Reviewing Tax Returns for Column A Determination". In addition, the section "Dealing with Math Errors" can be referenced for information concerning math errors. Once the amended return is perfected, Column C of the amended return (or Column C of the EDA-25 used to perfect the amended return) will be used for Column A of the EDA-25 that is used to process the audit adjustments.
- If the taxpayer states that they have filed an X and the X is not attached to the audit in GenTax, then the auditor needs to locate this X. To locate the X, the auditor will need to look at the

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work items found in the taxpayer's account in the Work Items sub-tab under the Task Tab in GenTax. Request that Audit Planning order the X and have it attached to the audit. This X must then be worked in the same process as described above.

An audit involving an IL-1120-X claiming an overpayment is coded OC (if the claim is allowed as filed), OC/CR (if the claim reduction is unagreed) or OC/WC (if the claim reduction is agreed).

b) The Need for Multiple EDA-25s

When a case involves audit adjustments AND net operating loss carryback adjustments or capital loss carryback adjustments, it is necessary to prepare multiple EDA-25s, which reflect each "step" in the liability computation process. The purpose of multiple EDA-25s is to identify the various liability or overpayment amounts for restricted interest computations and to verify the loss amounts being applied.

- The audit adjustments (Illinois and/or federal RARs) should appear on the first EDA-25. Each loss adjustment is reflected on a separate, subsequent EDA-25.
  - CIT Standalone - All of the EDA-25s should be printed out for inclusion in the audit package. The last EDA-25 should be saved.
  - APT package - APT is designed to allow the auditor to complete multiple Auditor reports (EDA-25s) for each year of the audit. These reports are saved within APT. See the APT Reference Guide in the Audit Training Section under *Work Areas* on the Intranet for detailed instructions on EDA-25 completion.
- If there are multiple EDA-25s to be processed for the same year, then the auditor should clearly indicate on the top of each EDA-25 which should be processed first, second, third, etc.

Example: Company A filed its 2000 IL-1120 (its year of incorporation) on October 15, 2001 with Illinois base income of $100,000. On December 10, 2002, Company A filed an IL-1120-X carrying back its 2001 Illinois net loss of $60,000 to 2000. Note: Box on the 2001 IL-1120-X was not checked to forgo the carryback.

On November 15, 2003, Company A filed an IL-1120-X carrying back $40,000 of its $50,000 2002 Illinois net loss to 2000. Note: Again, the box on the 2002 IL-1120-X was not checked to forgo the carryback.

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During 2004 Company A's 2000 return is audited and Illinois net income is increased by $10,000 creating an audit deficiency.

Year - Return	Filed Date	Base Income	CB Amount	CB to year	IL Net Income
2000 IL-1120	10/15/2001	$100,000			
2001 IL-1120X	12/10/2002		$60,000	2000	
2002 IL-1120X	11/15/2003		$40,000 – had $50,000	2000	
Audit in 2004 of TY 2000					Increased by $10,000

Multiple EDA-25s are required for the audit of TY2000 as follows:

- When EDA-25s are prepared for 2000, the first EDA-25 will reflect the As Filed figures from Column A and the Audit Results in Column C.
- The second EDA-25 will reflect the figures from Column C of the first EDA-25 in Column A, and the Audit Results after the 2001 Illinois net loss carryback in Column C.
- The third EDA-25 will reflect the figures from Column C of the second EDA-25 in Column A, and the Audit Results after the 2001 AND the full $50,000 of available 2002 Illinois net loss carrybacks in Column C.
- All three EDA-25s should be printed out for the audit file. An IL-870 should be prepared for the taxpayer's signature, only if audit is completed using DAN. If completed in APT, the IL-870 is no longer required. It should reflect the tax resulting from the $10,000 audit income increase and a corresponding tax decrease to reflect the additional IL NOL that was carried back to 2002 to offset the full amount of the audit change.

c) Completing the EDA-25 with a Previous Audit That Has Not Been Posted to GenTax

If there is a previous audit on a tax year that is included in the current audit cycle, and the previous audit has been completed but not posted to GenTax, the auditor will need to obtain a copy of the EDA-25 from that audit. The Column C of the prior audit will have to be used for the Column A of the current EDA-25.

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d) Completing the EDA-25 When the Prior Audit Remains in Administrative Hearings & Litigation or the Audit is impacted by a Separate Audit That Remains in Administrative Hearings & Litigation

In these cases, unless the settlement agreements are signed, any subsequent audit adjustments for the protested audit years and carry years must use the unagreed audit figures. Audits are not to be held when an unagreed audit in Administrative Hearing and Litigation is involved. The audits are to be worked using the unagreed figures. When the settlement agreement is finally signed, then the Audit Perfection unit will adjust all related audits accordingly per the settlement agreement.

- If the current audit that the auditor is working has a prior audit for the same year in Administrative Hearings and Litigation and the settlement agreements are not signed, then the auditor must use the Column C, unagreed figures from the audit done prior to the audit they are conducting, when completing the Column A for the EDA-25 for the subsequent audit. This situation may happen in the case of additional changes from an RAR.

- If the current audit that the auditor is working has losses that are carried from a year that remains in Administrative Hearing and Litigation, then the auditor must use the loss amounts from the unagreed audit to carry to this tax year.

  - To get the unagreed figures for all audits in which the Notice of Deficiency was issued March 1, 2010 and after, the auditor can use GenTax. In the Audit View under the Working Papers sub-tab, see the Working Papers and click on the working paper that shows an approved status for the tax year you need. This working paper will contain the unagreed figures from the audit that is in Administrative Hearings and Litigation, which should be used to complete the current audit.

  - To get the unagreed figures for all audits in which the Notice of Deficiency was issued prior to March 1, 2010 the auditor must use the CAF.

B. EXPLANATION OF ADJUSTMENTS (EDA-27)

The EDA-27 gives an explanation of each line item audit adjustment made. Dollar amounts (where applicable) must be shown for every item of adjustment and each adjustment must be explained with citations from the Regulations and/or Tax Act.

The EDA-27 must be completed for ALL audits, both agreed and unagreed. An EDA-27 **must be** presented to the taxpayer (or taxpayer representative) with the appropriate

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ICB notice (for audits completed in Dan - EDA-122, 124 or 125 and for audits completed in APT – EDA-122-B-APT, 124-I-APT or 125-I-APT).

- If a line item audit adjustment contains more than one item being adjusted (for example, two different items of non-business income being disallowed) then both items need to be broken down and explained on the EDA-27.

- For unitary audits, group membership changes must be discussed in the EDA-27. Companies which are being excluded or added as an "as filed" unitary group should be identified. Refer to Chapter 23 for a discussion of the information which should be included in a Unitary Determination and proper documentation of that report.

An Income Tax Notice of Deficiency must identify and explain the audit adjustments creating the proposed assessment. If the auditor does not properly identify the audit adjustments, it is difficult for Technical Review to prepare the Notice of Deficiency. For this reason, EDA-27s are reviewed very closely.

- Automated Notice of Deficiencies are now being generated. EDA-27s are the primary documents used in this automated Notice of Deficiency. For the automated Notice process to work and be correct, the EDA-27s must be very specific as to all adjustments made in the audit and must cite the correct paragraphs of the IITA and/or sections of the regulations which support the audit adjustments. Categories such as "computational errors" should be used sparingly.

1. APT EDA-27, Explanation of Adjustments

For audits completed in the CIT package (APT), the auditor should use the EDA-27 that is self-contained within that program. See the APT Reference Guide for details.

2. GenTax EDA-27, Explanation of Adjustments

Starting June 22, 2015, the EDA-27, Explanation of Adjustments, became available in GenTax under the CRM tab, Letters sub-tab on the Audit Springboard.

For audits completed in DAN or CIT Standalone, this GenTax generated EDA-27 will be the only one accepted by Review/Perfection from 6/22/2015 forward. For audits completed in APT, the self-contained EDA-27 must be used out of that program.

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Completing the EDA-27 in GenTax

The EDA-27 can be accessed in the Audit Mail Types by clicking on the "Add" in the Letters sub-tab under the CRM tab on the Audit Springboard.

When applicable, an EDA-27 must be prepared (then saved) for each tax year under audit. Once the EDA-27 has been selected from the list of letters as shown above, it will be necessary to select the tax year that the form is being prepared for by clicking on the drop-down arrow in the *Filing Period* box, which opens showing the years under audit.

Once the tax year has been selected, the variables will be visible. The EDA-27 has been programmed to only show the variables which are applicable for the tax type and tax year.

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It is necessary to select at least one variable…. Therefore, the "include" column is yellow (see above), which indicates it is a required field. Once one variable is selected, the "include" column will turn green. The variables can be sorted/filtered using the green "filter" field which is used in other GenTax documents also.

Some variables, like the Federal information displayed below, will not allow for the entry of figures in the "income change" and "tax impact" columns.

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Other variables, where an income change and tax impact is applicable, allow for such entries.

Although available, the “Free Form” options found in each set of variables should only be used if no citation is applicable. Before using the “Free Form” option, the proposed citation must be approved by the supervisor.

Visible on the input screen is a running total for both the “income changes” and “tax impact”. This programmed function is for the auditor’s benefit for ensuring that the total dollar amounts are accounted for when being entered. These totals will NOT print on the actual EDA-27.

Like other letters, the EDA-27 should be reviewed prior to printing by clicking on the *Preview Letter* tab.

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And, like other letters, the EDA-27 will need to be saved.

C. WAIVER OF RESTRICTIONS (IL-870)

The IL-870 essentially is the audit "agreement" form on which taxpayers not only consent to the audit results, but also waive their rights to a Notice of Deficiency and Administrative Hearing under IITA §904 and §908. (The taxpayer may still, however, pay the tax and subsequently file a claim.)

Note: For audits being completed in the CIT package (APT), the IL-870 will no longer need to be issued. See the APT Reference Guide for further details concerning this procedure change.

- The statutory deficiencies or over-assessments (reflected on the IL-870) are the increases or decreases in tax assessed, NOT the underpayment or overpayments. It represents the tax, penalty and interest CHANGES proposed in the audit.
  - These amounts are the increases or decreases to tax found in column "B" of the Auditor's Report. They should NOT include any previously assessed amounts (outstanding balances due) or pending refunds.
    - Example: If the audit increases tax by $7,000, resulting from changes to the apportionment formula, and the taxpayer still has an unpaid balance of $3,000 due to a valid math error on the original return, only the $7,000 is shown on the IL-870. This is the increase found in column "B" of the Auditor's Report, not the total underpayment found at the bottom of the form.

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- If the statutory deficiencies or over-assessments on the IL-870 are different from the actual under or overpayment at the bottom of the Auditor's Report, the difference should be explained in the "REMARKS" section of the IL-870 and explained in the Auditor's Comments.

When the proposed audit liability is being completely offset by Illinois net loss or excess credit carryforwards, the IL-870 should be completed as follows:

- The pre-loss or pre-credit audit tax liability should be entered as a positive number in the liability section.
- The identical reduction to the audit liability due to the loss or excess credit carryforward should be entered as a decrease (brackets) in the liability section.
- Any past statute refund amounts should be listed in the comments section and the net amount available to be refunded should be listed.

When only a portion of the proposed audit liability is being offset by the Illinois net loss or excess credit carryforwards, the IL-870 should be completed as follows:

- The pre-loss or pre-credit audit tax liability should be entered as a positive number in the liability section.
- The partial reduction to the audit liability due to the loss or excess credit carryforward should be entered as a decrease (brackets) in the liability section.
- Penalty and interest amounts based on the net liability should be entered as a positive number in the liability section.

For complete information on penalty and interest determination on the IL-870, see Chapters 42 and 43.

Note: The IL-870 cannot be used for adjustments that indicate zero tax changes, such as loss increases or loss reductions. These can only be agreed to by the taxpayer signing an amended return.

1. Generating the IL-870 from GenTax

When generating the IL-870 out of GenTax, the **IL-870M needs to be used**, as opposed to the IL-870, which should only be used for in-house automated WIT audits. Old standalone IL-870s should no longer be utilized. For audits completed in APT, an IL-870 no longer needs to be issued. See the APT Reference Guide for details.

When in the Audit View, click on the Letters sub-tab under the CRM Tab, then click on the Add Tab.

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[redacted]

Click on the IL870M blue hyperlink in the *Type* column.

[redacted]

Complete the Input screen, then review the letter through the Preview Letter Tab before saving and printing the IL-870M.

[redacted]

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2. Superseding Versus Withdrawing Documents

If a taxpayer has signed returns or an IL-870, these documents cannot be superseded, they must be withdrawn. The auditor must take care to ensure that the changes that are requested on the more recent return/IL-870 are in statute.

> Example:
> A taxpayer filed a timely IL-1120-X for a claim that was later withdrawn to increase the taxpayer's claim. The problem is that the new 1120-X is out of statute to request any claim, and since the earlier claim was withdrawn, both are out of statute to request a claim.

Processing issues exist in cases where the auditor has written "superseded" across signed IL-1120-Xs or IL-870s, or the auditor used "superseded" in their language on these forms. The correct language should have been "withdrawn". Unless the taxpayer withdraws that IL-1120-X or IL-870, these are active forms and must be processed.

D. AUDIT COMPLETION LETTERS (EDA-143-XX)

The Audit Completion letter sets the Audit Completion Indicator and the Inf-Audit Complete informational transaction. The date in the transaction is used to calculate the UPIA 5 penalties at 20% on additional tax due after an audit has been completed. Without the Indicator the UPIA 5 penalties cannot be calculated correctly. Therefore, **all** audits must have an Audit Completion Letter (generated from GenTax) sent to set this indicator and transaction.

Available Audit Completion Letters:

EDA143CA	Results – Return Approval *
EDA143I	Results – IL-870 Information
EDA143IAPT	Results – APT Auditor Reports [only for audits completed in APT]
EDA143LR	Results – Net Loss Info (see Chapter 35 for details)
EDA143NC	Results – No Liability
EDA143RR	Results – EDA-153

* On May 25, 2015, a new GenTax Audit letter became available for Income Tax audits. Up until that point, Income Tax auditors had no access to a Notice of Audit Results which can be issued to cover an audit which contains both original and amended returns. The new EDA-143CA allows for this. In addition, the former results letter did not contain the required language for returns filed with unpaid balances which could be subject to additional penalty. The EDA143CA "Results Return Approval" replaces the

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following results letters: EDA143CA "Results- Amd Return Approval" and EDA143CO "Results-Original Return Approval".

See Exhibit K, How to Create the Audit Completion Letter.

The Field Auditor will generate the Audit Completion letter the date that the IL-870 is issued to the taxpayer or the last day that the auditor charges hours to the audit.

- For audits in which an IL-870 is **required to be issued**, the completion date is the date that the taxpayer is issued the IL-870. For income tax, if an IL-870 is required to be issued for any audit year included in the track, all years in the audit will use the "Date of Issuance" on the IL-870 as the completion date.
  - The completion date is **NOT** the date that you send the audit to your Supervisor.
  - Auditors can still charge hours to the audit after the IL-870 is issued.
  - The Audit Completion letter is responsible for creating the audit completion indicator and transaction, so that any future tax increases will be assessed the 20% UPIA penalty. If a second IL-870 is to be issued to the taxpayer or if additional audit changes have been made that warrant a second completion letter, the first audit completion letter must be invalidated, and the audit completion indicator ceased and transaction ("Info Trans") reversed (see Note below). This way when the second completion letter is created, the new audit completion date will be used to determine if the additional 5% UPIA penalty should be assessed.

    Note: Field and in-house staff should email Steve Manci or Tad Tucker to request the completion indicator be released before the second completion letter can be generated. The "Info Trans" transaction will be reversed also.
- For audits in which an IL-870 is **not required to be issued** for any audit year in the track, the completion date is the last day that the auditor charges hours to the audit. This includes but is not limited to:
  - No Liability audits
  - Claims filed by a taxpayer that are accepted as filed
  - Decreases or increases to losses or credits

Note: Once audit hours are charged to the last day, the audit should go to the RAS for review, and the audit should no longer be in the auditor's inventory.

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- If additional liability is established after an EDA-143NC (no liability) has been issued, the letter can be invalidated before the audit is posted. The auditor will need to revise workpapers and contact the taxpayer to let them know of the changes.

E. AUDITOR'S COMMENTS (EDA-64)

The EDA-64, Auditor's Comments, is one of the most important tools for an auditor to use throughout the audit process. This narrative is considered a "living" document, which should be started early in the audit process and then added to throughout the course of the audit. The Auditor's Comments should contain a thorough write-up of the items/issues as they are researched, considered and determined during the audit.

Procedures have been developed to standardize the headings and the appearance of the Auditor's Comments yet remain flexible for auditors to individually develop their audits according to their own thoughts and writing ability. The Comments should follow the suggested format.

Auditor's Comments should include the following sections:

- Cover
- General Background Information
- Discussion of Issues
- Taxpayer Position
- Auditor's Conclusion
- Specific Processing Notes
- Exhibits

1. Cover

The Cover page includes the following information:

Title (AUDITOR'S COMMENT SECTION)
Date of Report
Taxpayer Information
  Name
  Address
  City, State, Zip
Taxpayer FEIN
Audit Period
Audit Discussed With
  Name, Title, Address (if different than above)
  Phone Number

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2. General Background Information

This section should provide a brief description of the taxpayer's corporate history including the date of incorporation and its business activity and corporate structure. (If the taxpayer is a member in a unitary business group, an in-depth discussion of the business activity and corporate structure will be included in the unitary determination.) It should also include a history of the taxpayer's filing status.

The following guidelines reflect examples of the type of questions to be answered or information to be provided in this section. As each taxpayer is distinctively different, the Auditor should develop his/her own synopsis of each account, keeping in mind the following areas:

- The date the taxpayer began filing in Illinois. If the taxpayer is a non-filer, this issue should be developed in the "Discussion of Issues" section.

- Briefly describe the history of the taxpayer's account.
  - Has the taxpayer's filing method changed?
  - What is the current status of the taxpayer's account?
  - Were there any adjustments made to prior years which affect the current audit period?
  - Are there any outstanding math errors?
  - Were they resolved prior to the beginning of the current audit?

- Identify the following dates, where applicable to the case, in order to properly monitor the various statutes involved:
  - The original due date
  - The extended due date
  - The date the original return was filed
  - The statute for any math errors
  - The date of any liens
  - The date any claims for refund were filed reflecting state or federal changes
  - The last day to issue a Notice of Deficiency

- For separate basis (non-unitary) taxpayers, describe their principal business activity and operations. What is the product line? Are there multi-state sales? Nexus in other states (for purposes of throwback sales, application of PL 86-272, etc.)? If any of the above represents issues, full discussion should be given in the "Discussion of Issues" section.

- Unitary determinations will normally be an issue and should be fully discussed in detail in the "Discussion of Issues" section. When the taxpayer and the auditor agree that the original returns were filed under the correct unitary determinations, the auditor should provide statements to this effect and a brief but exact description of the unitary business.

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- Complete listing of entities that have nexus and what is creating that nexus activity.

- The reason for the audit referral.

3. Discussion of Issues

This section of the Auditor's Comments is probably the most important part of the entire audit, especially in the event of an unagreed audit. Should the taxpayer wish to litigate the audit in court, there is a very good chance that NO further evidence will be produced during the hearing other than that already in the audit. Therefore, it's imperative that each issue be developed as fully as possible, by identifying source documents, etc.

Evidence is something presented to a court which tends to establish or prove an allegation or point in question. It is an auditor's responsibility to gather all relevant evidence before reaching a conclusion. The evidence should be documented in the audit work papers and should establish both the auditor's and the taxpayer's position on the issue(s). If an adjustment is proposed and the taxpayer disagrees, the evidence on which the taxpayer bases his position is important to anyone attempting to resolve the issue.

A full explanation of the audit issues should be provided. The unitary determination is included in this section, in addition to an explanation of the modifications, non-business income, partnership income, apportionment formula, intercompany eliminations, nexus, throwback sales, penalties, interest, etc., involved in the specific case.

- The unitary determination will be developed from various sources of information. Each source shall be identified and referenced by "Exhibit A, B, C, etc." and placed in the "Exhibit" section. If the auditor, for example, is relying upon certain parts of the S.E.C., 10-K report as part of the unitary determinations, the discussion of this issue should include citation of the source and page number. The actual document (Exhibit 10-K) should be highlighted to take the reader specifically to the information relied upon, should an in-depth review be required.

- Unitary group membership changes must also be discussed in this section. Companies which are being eliminated or added to the "as filed" unitary group should be identified as well as the reasons for their exclusion or inclusion. Refer to Chapter 23 Unitary Determination.

Each item involved in the return should be explained fully. The following information should be included, where applicable:

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- How each item was originally reported.
- Type of adjustment(s), if any, made.
- The basis for each adjustment (i.e. IITA, Regulations, etc.).
- The amount of each adjustment.
- The books and records examined.
- The audit techniques and procedures used.
- Any other information which specifically explains the adjustment(s) and fully develops the issues.

Even if a specific item was not adjusted in the audit but its identity or what is included in the figure is not clear from the return(s) filed, an explanation and breakdown of the originally filed figure should be included in the Auditor's Comments.

Each adjustment must be supported by citing the proper authority (IITA, Regulation, Court case, etc.). The auditor should, in addition to identifying the proper citation, also provide an interpretation as well as its application to the issue.

Do NOT cite the following in the Auditor's Comments under any circumstances:

- the Audit Manual
- any Audit Manual Update (AMU)
- Technical Responses
- TAMs
- Revoked PLRs. Beginning back on July 1, 2002, every PLR is revoked on the date that is 10 years after the date of issuance.

Note: If the taxpayer submits an ICB-1, Request for Informal Conference Board Review, after the issuance of the EDA-122, 124, or 125 or EDA-122-B-APT, 124-I-APT or 125-I-APT, the auditor's comments can only mention the following:

- Date the taxpayer petitioned ICB
- Date ICB accepted or rejected jurisdiction
- Date ICB Action Decision is issued
- Results as stated in the Action Decision

NEVER reference email correspondence between the auditor and ICB, the Conferee Recommendation or any other activity that resulted during the ICB process.

4. Taxpayer Position

This section reflects the taxpayer's disagreements with the audit results. In discussing the examination with the taxpayer at the closing conference, the

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auditor should transcribe the taxpayer's verbal statements as accurately as possible.

- Many times the taxpayer's representative, due to lack of authority, will not be able to make legal statements at the closing conference. The audit results may have to be presented (by taxpayer's representative) to upper management or taxpayer's legal staff for discussion of legalities or hazards of litigation. In this case, the auditor should grant the taxpayer a short period of time (depending on the complexities of the issues) to prepare his arguments and present them in either another office conference or, preferably, in a written letter than can be used as a reference document in the audit file.

Whenever possible, do not allow the taxpayer to disagree based upon generalities. Have the taxpayer pin-point reasons for disagreement citing court cases, IITA, Regulations, legislative intent, etc. It is very important that accurate communication exists in this area, and that mere confusion is not the reason for an unagreed audit.

5. Auditor's Conclusion

This section will explain the final outcome of the audit. Included within this section may be:

- Comments on the degree of cooperation extended by the taxpayer.
- Identified specific problems encountered.
- Was the taxpayer offered an office conference?
- Summarize the amounts of deficiency, penalties, and interest for each year.
- Was an IL-870 signed and payment processed? (If so, identify the dates the form was signed and/or the payment received.)
- Is there at least **2 months** (60 Days) remaining on the statute for Technical Review, or does this case represent a priority requiring an immediate Notice of Deficiency?
- At the bottom of this section, the auditor must sign and date the report as follows:

Auditor's Name _____

Signature _____

Title _____ Date _____

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Audit conclusions are generally based on evidence, facts and inferences. Evidence is something which tends to prove a fact. A fact is a conclusion based on evidence about what actually happened. In making factual conclusions, the credibility of the evidence is evaluated, and the relative weight of conflicting evidence is judged. An inference is a conclusion based on the facts. It is important that the auditor's conclusion be based on these factors in supporting the Audit position.

6. Specific Processing Notes

Audit changes or adjustments per period should be well documented as to **specific** instructions for the processing of the audit. A processing checklist should be utilized as to what documents within the audit need to be processed. The following represent common processing issues and how they should be addressed:

- ✓ Auditor's Report/Amended returns – if multiple returns are included, indicate the proper order in which they need to be processed. Example: For the 2014 tax period, four amended returns have been included in the audit. The auditor must indicate the order in which these returns should be processed.
- ✓ Schedule UB changes –

  Note: For audits being completed in the CIT package (APT), the auditor must use the Schedule UB that is self-contained in that package. [Refer to the APT Reference Guide for details]. For audits completed outside of APT, CXC25SUP is required when adding separate Illinois filers to a combined return or combining two or more unitary groups that did not originally file as one unitary group.

  - if members have either been added or removed from the UB group, these changes should be indicated as to the members affected. The EDA-25 Supplemental (CXC25SUP) and the Schedule UB should reflect the changes and must be included for processing. For instructions on completing the CXC25SUP, see Chapter 28, Unitary Determination.
  - if there are changes to the IL-1120 Line 1 figures, a corrected Schedule UB must be provided.
  - if there are changes to Sales Everywhere and to Illinois Sales on the return, a corrected Schedule UB must be provided.

  Lines that need to be entered off of the Schedule UB for Members being added, deleted or changed are as follows:

  - Step 2, Line 28
  - Step 2, Line 29a
  - Step 2, Line 29b

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- Step 4, Line 2
- Step 4, Line 3
- Step 4, Line 6
- Step 4, Line 7
- Step 4, Line 9

✓ Capital Loss Carryback (C/B) – need all forms and specific documentation for any C/B change.

✓ Losses – loss schedules must be provided with specific instructions as to carryforward/carry back amounts. NOL screens must be reviewed and included in the audit for loss verification. Also, merged or acquired losses from other Corps must be indicated.

✓ Stop Processes – if a "stop" indicator is present in GenTax, any documentation received during the audit that addresses that issue, should be flagged with specific processing instructions.

✓ Manual Deactivation of the Credit – GenTax views a return correction adjustment as timely change in tax liability if the original return receive date is timely. A manual deactivation of the credit must occur to prevent this money from being refunded. The refund should be deactivated to prevent it being issued without a review of the statute of limitations issues. Specific processing instructions must be included if a manual deactivation is necessary.

✓ Schedules – the following need to be attached to the EDA-25 for proper processing in GenTax:

Tax Year	Required Schedules
2007 - 2008	Schedule 1299-D and Schedule UB
2009	Schedule 1299-D, IL-4562, Schedule M, Schedule UB
2010	Schedule 1299-D, IL-4562, Schedule M, Schedule 80/20, Schedule UB
2011 - 2016	Schedule 1299-D, IL-4562, Schedule M, Schedule 80/20, Schedule INL Schedule UB
Fiscal year 2011 only	Schedule 1299-D, IL-4562, Schedule M, Schedule 80/20, Schedule INL Schedule UB, AND Schedule SA

Note: In APT – required schedules (workpapers) are self-contained. See the APT Reference Guide.

✓ Auditor Created Spreadsheets – if the auditor creates a spreadsheet (or Word document) to support or explain adjustments in the audit, these supporting documents must be included in the audit, and specific processing instructions should be provided if these documents affect the processing of the audit.

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- ✓ Multiple EDA-25s – if multiple EDA-25s are required in the audit, supporting documentation must be attached to each EDA-25 as warranted.
- ✓ Superseded Forms – all superseded forms should be clearly marked and placed in the back of the audit file.
- ✓ EDAs for Down Foot Purposes – all EDAs that are down footed for verification purposes only should be clearly marked "**Do not process**" and placed in the back of the audit file.

7. Exhibits

Exhibits referenced in the text of the Auditor's Comments should be listed here in the order in which they appear in the narrative.

For Example:

Exhibit A – SEC 10-K
Exhibit B – Annual Report
Exhibit C – Executive Committee Minutes
Exhibit D – Organization Chart
Exhibit E – Policy Manual (Copies or Transcripts)
Exhibit F – Transcript of Interviews

F. AUDIT SCHEDULE FINALIZATION

The audit file is essentially the basis of the Department's legal case in any future protest proceedings, so the auditor should be thorough and precise. Many audit issues are won or lost at the hearing or court level based primarily on the quality and completeness of the audit. Even if the auditor is involved in the protest proceedings, the amount of time that may expire between the close of the audit and the protest proceedings could be quite lengthy. Without proper documentation, it would be very difficult for an auditor to remember precise details that are important to the defense of the Department's case.

The type and number of schedules vary slightly depending on the taxpayer's position regarding audit adjustments. Depending on the complexity of any specific case and the issues involved, additional schedules may be necessary. Specific comments are necessary where schedules normally prepared are not needed. It is important to remember that a sufficient amount of information should be included to allow the field office, Technical Review and the Office of the General Counsel to understand what adjustments were made and why.

1. Federal Schedules for Income Tax Audits

- Pages 1 thru 4 US 1120, US 1120S, US 1065, US 1041 (whichever is applicable, with supporting documents)

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- Pro-Forma Consolidated Income Statement & Balance Sheets, Schedule A, Cost of Goods Sold, Schedule C Dividends, and Schedule M-1, along with Schedule M-3 and Form 8916-A.
- Schedule 851 (Affiliations Schedule), list of shareholders, partners, beneficiaries, whichever is applicable
- Form 1120-FSC (Foreign Sales Corporation Return)
- Form 1120-F (Foreign Corporation Return)
- Schedule K-1 (Partner's share of income, credits, deductions, etc.)
- Schedule D (Capital Gains & Losses)
- Schedule 4797 (Sales of business property)
- Form 4562 (Depreciation & Amortization) for RTIC credits
- Form 6765 (Credit for increasing research activities) for R&D credits
- 10-K report or Annual report (Overview of a company's business), whichever is available

The above stated federal forms and schedules serve as documentation for potential issues to be examined in the table below.

AUDIT ISSUE TO BE EXAMINED	USEFUL FEDERAL DOCUMENTATION
Parent (controlling) corporation identification	Form US1120 – pages 1-4 with supporting docs to verify income, deductions, etc.
Unitary Grouping	Schedule 851, Form 1120-FSC with schedules, 10-K reports, Annual report, Form US1120 of companies not in the consolidated return, Schedule M-3 and Form 8916-A, Form 7004
Federal Taxable Income	Consolidating income statement, Form 1120-F, Form 1120-FSC
Partnership Income (Form US1120 – Line 10)	Form US1065, Schedule K-1 for each partnership interest
Non-business income	Schedule D – Capital gains (losses), Schedule 4797, any other federal schedule indicating non-business income

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Modifications	Page 4 US1120 M-1 detail schedule, Schedule C dividend schedules
Credits	Federal depreciation schedules Form 4562, Form 6765, R&D credits
Everywhere factors	Consolidating balance sheets, Schedule A, CGS detail statement

2. Illinois Schedules for Income Tax Field Audits

- PROD-1
- EDA-51 Audit Index
- IL-872 Consent to Extend Statute, if applicable
- IL-870 Consent for Assessment or Overpayment
- Unitary Payment Offset Schedule, if applicable
- IDR-829 Great Lakes States Questionnaire
- Auditor's Comments
- Letter of Comments for IL-1040/1041/1065/1120-ST/WIT
- EDC-5 Audit History
- IL-2848 Power of Attorney, if applicable
- EDA-122 Notice of Proposed Deficiency
- EDA-123 Notice of Proposed Liability
- EDA-124 Notice of Proposed Deficiency& Claim Denial
- EDA-125 Notice of Proposed Claim Denial
- EDA-153 Acceptance of Revised Claim for Refund
- AUB-2, IF Unitary
- EDA-27 Description of Audit Adjustments
- Worksheets of Adjustments
- K-1-P (Partners & Shareholders) and K-1-T (Trusts & Estates)
- Completed EDA-24 (Ind.), EDA-25 (Corp), or EDA-26 (Fiduciary), EDA-92 (1065), EDA-93 (S-Corp), IL-1904 (WIT), EDA-3 (WIT Acc Filers), IL-1023-C (Composite), IL-1000 (Pass-Through Entity Payment)
- IL-1120-X (1120), IL-1065-X (1065), IL-1120-ST-X (1120-ST), IL-1041-X (1041), IL-1023-C-X (1023-C), IL-1040-X (1040), IL-941-X (WIT), if obtained
- Worksheets for Penalty and Interest, if applicable
- Schedule of Property/Payroll/Sales Everywhere and IL
- State by state break-down factor(s), allocation working papers
- RTIC Gross Receipts Test Schedule (CXGRRCPT)
- Loss Schedules, if applicable (CXILLOSS, CTILNLD, CXUSNL5G, etc.)
- Loss Reduction Letter, if applicable
- Verification of payments (if not covered in printout)

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- EDA-8-A Collection/Legal Action Support, if applicable
- ICB Action Decision, if applicable
- IL-3990 Reviewer's Memorandum, if applicable

It is not necessary to prepare Property, Payroll and Sales factor schedule; however, property, payroll and sales should be reviewed for all companies. If they are prepared, they must be included in the audit file.

The RTIC Gross Receipts Test is required in all audits for years ending on or after January 1, 1994 where the taxpayer claims the RTIC. Therefore, the schedules and workpapers prepared as a result of performing the test must be included in the audit file.

In audits where the taxpayer is claiming federal net operating losses or Illinois net loss carryovers, the Auditor is required to verify the loss carry over. All schedules and workpapers generated in that verification process must be included in the audit file.

All working papers generated in the audit should be placed in the file without exception.

G. AUDIT WORKPAPER SUPPORT

Audit working papers are the connecting link between the taxpayer's records and the auditor's report. They document all of the work done by the auditor and provide the justification for the auditors' adjustments. Working papers can take on many different forms such as:

- analyses of ledger accounts
- photocopies of minutes of directors' meetings
- organization charts
- flowcharts
- working trial balances
- audit programs
- Questionnaires
- letters of representation from the taxpayer or legal counsel
- intra-departmental correspondence
- State by state allocation working papers (should be a requirement)

All of these schedules, notes and documents are part of the auditor's working papers. Thus, the term **audit working papers** includes all final and superseded documents that have been given to the taxpayer.

Additional benefits to well-prepared audit working papers include:

- documenting an issue that may go to administrative hearings, independent tax tribunal, or court

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- aiding managers and supervisors in reviewing the auditor's work by providing the support for the auditor's report
- aiding in planning and conducting future audits of taxpayers. In addition, working papers that are given to the taxpayer provide useful information for preparing their future income tax returns.

H. EDA-153 ACCEPTANCE OF REVISED CLAIM FOR REFUND

~~1. Purpose of the EDA-153~~ This section being moved to Ch. 39. Updated Ch 39 not approved/released out yet.

[redacted]

- [redacted]
- [redacted]
- [redacted]

See Chapter 39 – Amended Returns and Claims for details on the EDA-153.

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XI. CLOSING CONFERENCE

During the closing conference with the taxpayer, the auditor will:

1) Maintain confidentiality per IITA § 917.
2) Review the audit results with the taxpayer.
3) Determine the collectability of any liability.

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A. CONFIDENTIALITY

It is important to reference the effect of the Confidentiality Clause when discussing audit results with taxpayers and/or their representatives as seen in IITA § 917. There are exceptions to the confidentiality restrictions within § 917, as the provisions do not apply if the information is being provided to a licensed attorney representing the taxpayer where an appeal or protest had been filed on behalf of the taxpayer.

The question of confidentiality occasionally arises in the performance of unitary apportionment audits. Many times, a corporation may own a subsidiary during the audit period however the parent has sold the subsidiary's stock prior to the actual audit procedure. If the two companies are determined to be members of a unitary group, the findings of the audit, when discussed with one company, will contain information regarding the other, now unrelated, corporation. The Department would consider any official discussion of audit findings with the taxpayer as within the scope of `official procedures for collection of state tax'.

See Chapter 1 for more information on Confidentiality.

B. AUDIT REVIEW WITH TAXPAYER

Important: Before the audit is ever reviewed with the taxpayer, all final working papers must be reviewed with and approved by the RAS. This alleviates any questions/issues that may arise if "supervisor reviewed" after being presented to the taxpayer.

- Each proposed adjustment detailed in the audit working papers must be discussed with the taxpayer. An EDA-27, Explanation of Adjustments, **must be** presented to the taxpayer (or taxpayer representative) with the issued ICB notices (EDA-122, 124 or 125, or EDA-122-B-APT, 124-I-APT or 125-I-APT).
    - It should be made clear to the taxpayer, or the taxpayer's representative, that the schedules are the auditor's recommendations which are subject to review by both the field office and Technical Review, and, that further work may be necessary if either takes exception to the schedules prepared.

- The audit conclusion and processing procedures should also be explained.
    - If the taxpayer agrees to a proposed adjustment, every attempt should be made **to get prompt payment** of the tax, penalty and interest, plus signature(s) on the IL-870. The IL-870 not issued in audits completed in APT.
    - If the taxpayer disagrees, the protest and hearing procedures should be explained.

- Once the working papers have been thoroughly reviewed by the taxpayer, any additional information submitted by the taxpayer has been examined and the

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working papers revised as necessary, the final step in the audit process is arranging all of the various working papers, evidence and processing forms into an Audit package.

C. ISSUANCE OF INFORMAL CONFERENCE BOARD (ICB) FORMS

ICB forms must be issued unless NL or statute is expiring within 60 days. These forms include:

1) For audits completed outside of APT –
   - EDA-122 (the 122B in Gentax)– Notice of Proposed Deficiency

   If there is no tax liability, do not issue this form.
   - EDA-124 (the 124I in Gentax) – Income Tax Notice of Proposed Liability and Claim Denial
   - EDA-125 (the 125I in Gentax) – Income Tax Notice of Proposed Claim Denial

   If the claim is agreed to, do not issue this form.

2) For audits completed in APT –
   - EDA-122-B-APT
   - EDA-124-I-APT
   - EDA-125-I-APT

   These new letters for APT audits are still generated in Gentax from the Audit Springboard and have the same functionality. These new letters have been modified to conform to the new procedures that have been put in place with the APT program. Specifically, the changes related to when a taxpayer can sign auditors reports with the Jurat language to agree to an audit at the ICB rights level. These letters are the same but remove the IL-870 language since the taxpayer is being prompted to sign auditor's report(s) instead.

[redacted]

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Any discrepancy with the auditor's proposal will require that the supervisor discuss further issue development, removal of an issue or request additional documentation to be obtained to support the issue. **ICB forms cannot be issued until these items are addressed. Additionally, ICB forms can be rescinded with Division Manager approval.**

Informal Conference Board forms (ICB-1 and ICB-2) should be issued along with the EDA-122, 124 or 125, or EDA-122-B-APT, 124-I-APT or 125-I-APT. Note: Forms ICB-1 and ICB-2 have been updated as fill-in savable pdf forms that can be accessed on the Department's website under Forms, Other, Informal Conference Board.

1. Prior to Issuance of ICB Forms

Auditor's Letter of Comments should be prepared and submitted to supervisor for review prior to the issuance of the ICB forms. The supervisor must agree with the established audit issues before the taxpayer is presented with the ICB forms.

Supervisors must make sure all necessary documentation request forms have been utilized prior to issuing the ICB forms. The Informal Conference Board should not be the forum for which an auditor attempts to secure additional documentation for the audit. This additional documentation would include the issuance of a Technical Support Request.

2. Audit Agreement after Issuance of ICB Forms

If the taxpayer agrees with the audit results after the issuance of the ICB forms and prior to the expiration of the 60 days allowed, they must provide their agreement to the auditor **in writing.** In those instances, the auditor should issue the EDA-143 Notice of Audit Results letter with the IL-870 within 5 days of such notification (the IL-870 not issued in audits completed in APT). If the taxpayer signs the IL-870 at that point, they waive their rights to review under ICB.

3. Informal Conference Board Audits

a) While under ICB Jurisdiction

Any and all requests from the ICB should be handled as a priority. If additional information is obtained at the ICB conference, the auditor must review the documentation as a priority and respond to the Conferee on the acceptance or denial of the data.

b) Once the ICB has issued an Action Decision

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The auditor must contact the taxpayer within 8-15 days of the Action Decision to continue the audit process or to obtain additional documentation as directed. The auditor must submit the completed ICB audit for supervisor review within 60 days of: receipt of final decision by the ICB, the passage of any document deadline, or upon receipt of the required additional documentation.

c) How to Address ICB Activity in Auditor's Comments

If the taxpayer submits an ICB-1, Request for Informal Conference Board Review, after the issuance of the EDA-122, 124, or 125, or EDA-122-B-APT, 124-I-APT or 125-I-APT, the auditor's comments can only mention the following:

- Date the taxpayer petitioned ICB
- Date ICB accepted or rejected jurisdiction
- Date ICB Action Decision is issued
- Results as stated in the Action Decision

NEVER reference email correspondence between the auditor and ICB, the Conferee Recommendation or any other activity that resulted during the ICB process.

D. DOCUMENTS ISSUED IN AUDITS – AGREED, UNAGREED, OR HAVING BOTH

The following chart shows the documents that should be issued in agreed or unagreed audits, and audits that may have both agreed and unagreed issues.

Note #1: An EDA-27, Explanation of Adjustments, **must be** presented to the taxpayer (or taxpayer representative) with the issued ICB notices (EDA-122, 124 or 125, or EDA-122-B-APT, 124-I-APT or 125-I-APT). See Section X.B for details on the EDA-27.

Note #2: Reference in the chart below to the issuance of the IL-870 does not apply to audits completed in APT. See the APT Reference Guide for details.

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Audit Type	Agreed	Unagreed	Both
Documents Issued	ICB-1 issued with either an EDA-122, EDA-124, or EDA-125 dependent on audit findings. The taxpayer is required to provide a written statement to bypass ICB. Within 5 days of receipt of statement: IL-870 issued, and EDA-153 (if applicable). If taxpayer signs IL-870, proceed to close audit within 15 days.	ICB-1 issued with either an EDA-122, EDA-124, or EDA-125 dependent on audit findings. Taxpayer has 60 days to submit ICB-1 form. If taxpayer does not submit ICB-1 within the 60 days, EDA-143 is issued with an IL-870.	ICB-1 issued with either an EDA-122, EDA-124, or EDA-125 dependent on audit findings. **Agreed Issues** The taxpayer is required to provide a written statement to bypass ICB. Within 5 days of receipt of statement: IL-870 issued, and EDA-153 (if applicable). If taxpayer signs IL-870, proceed to close audit within 15 days. **Unagreed Issues** Taxpayer has 60 days to submit ICB-1 form. If taxpayer does not submit ICB-1 within the 60 days, EDA-143 is issued with an IL-870.

The above documents needing to be issued are accessed through Gentax when under the Audit ID number. Audit letters can be added through the *Letters* sub-tab under the *CRM* tab by clicking on the *Add* tab.

The *Mail Types* screen will open allowing the auditor to select the appropriate letter needing to be generated from the *Type* list as shown below (click on the appropriate letter hyperlink). Once the particular letter has been completed, it should be proofed for any errors, then printed and saved.

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[redacted]

EDA-124I and EDA-125I

Both the EDA-124I (Income Tax Notice of Proposed Liability and Claim Denial) and the EDA-125I (Income Tax Notice of Proposed Claim Denial) have been revised to include the ability to enter claim filing dates for each tax year under audit. The original letters had been designed under the assumption that all claims within the audit would have been filed on the same date.

Note: The EDA-124IAPT and EDA-125IAPT should only be used when completing an audit in the CIT package – APT.

EDA 124I "Income Tax Notice of Proposed Liability and Claim Denial":

[redacted]

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[redacted]

EDA125I "Income Tax Notice of Proposed Claim Denial":

[redacted]

E. ISSUE FORM EDA-8-A, COLLECTION/LEGAL ACTION SUPPORT

In order to assist the Collections Bureau in pursuing collection activity allowed by law, including wage levies, bank levies, accounts receivable levies, 100% personal liability penalty for "trust" taxes, and seizures, Form EDA-8-A, Collection/Legal Action Support, has been developed. (A trust tax is any tax for which an amount is required to be collected or withheld by a taxpayer from another person, regardless of whether it is in fact collected or withheld.)

Because auditors have access to taxpayer's books and records during an audit, information useful to Collections may be more easily obtained at the audit level.

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1. Factors Determining EDA-8-A Completion

Form EDA-8-A is required for non-publicly traded corporations, partnerships and sole proprietorships for BIT, IIT and WIT audits when any of the following factors is present:

- There is a current collection activity for any year; or
- An audit liability is not paid, whether unagreed or agreed; or
- A Jeopardy Assessment appears warranted during the audit. Refer to Jeopardy Assessments section.

A major purpose for completing the EDA-8-A is to have a record of all Illinois assets for any potential Lien Determination. For Unitary Income Tax purposes, every company with Illinois nexus should be listed showing the Illinois assets (**if** this information is available).

a) Current Collection Activity

By entering the taxpayer's FEIN, SSN or name through the Search Manager, the information on record will be accessed showing the tax types that the taxpayer is registered for. Important indicators will be visible at the top of the screen. A "Collection in Progress" indicator will be present if there is collection activity.

Collections information can then be accessed by clicking on the Collection Tab.

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More collection details can be seen by clicking on the Collection number hyperlink.

[redacted]

b) Outside Collection Agency

It is also important to research the taxpayer for any outstanding balance(s) that have gone to an **outside collection agency** (OCA) as indicated below. See Section VI.A (that addresses an OCA and the Statement of Customer) for more details.

[redacted]

2. Form EDA-8-A

If required, the auditor should issue an EDA-8-A, which the taxpayer should complete and return back to the auditor. Once that taxpayer has provided this information, the auditor will need to follow the instructions in the next paragraph.

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When dealing with a "paper audit":
The EDA-8-A (as a fill-in savable pdf) can be accessed on the Department's Intranet under Work Areas, Audit, Forms. The form must be filled-in, printed and saved by the auditor. Since the completed EDA-8-A must go in the audit file, saving it with the other audit paperwork and/or forms is recommended. Once completed and saved, the EDA-8-A will be part of the Continuing Audit File (CAF).

When dealing with an audit through APT:
When utilizing the CIT package (APT), the self-contained EDA-8-A should be used for audits completed in APT. The savable pdf discussed above should not be used with APT.

When dealing with an electronic audit through GenTax:
The EDA-8-A (as a fill-in savable pdf) can be accessed on the Department's Intranet under Work Areas, Audit, Forms. The form must be filled-in, printed and saved by the auditor. This form should then be added/saved to the "Electronic Documents" in GenTax.

Completing the EDA-8-A is not intended to take a significant amount of time. The Collections Bureau is requesting concise answers, rather than lengthy responses. Please be aware of the requested information throughout the audit's progression. If some of the information is unknown or not available, write such on the appropriate line.

Collections will be able to access the EDA-8-A as an attachment to the audit springboard as currently performed for Sales tax Audits.

See Exhibit L for an example of the EDA-8-A.

F. JEOPARDY ASSESSMENTS

IITA § 1102, and Retailers Occupation Tax Act (35 ILCS 120/5a) authorize jeopardy assessments. These assessments are also authorized by statute for other taxes administered by the Department.

Jeopardy assessments are warranted if the taxpayer is, or appears to be:

- planning to immediately leave Illinois or hide;
- planning to quickly place their property beyond the reach of the state by removing it from Illinois, by concealing it, by dissipating it, or by transferring it to other persons;
- preparing to do some other act that would tend to prejudice or render wholly or partly ineffectual the ability to collect the audit liability.

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Jeopardy assessments cannot be made just because the statute of limitations for assessing the tax is about to expire or because a taxpayer does not consent to extend the statutory period. A jeopardy assessment can be issued only if the collection of the tax deficiency is in jeopardy for the reasons described above.

1. Termination of Taxable Year – Applies to Income Tax

A termination of taxable year is covered under IITA § 1102(b) and applies only to the current tax year. (IITA § 1102(a) applies to all other years.) The same criteria to invoke IITA § 1102(a) apply to IITA § 1102(b). The difference is that 1102(b) assessments apply to current years and IITA § 1102(a) assessments apply to all other years.

The authority for termination assessments is contained only in IITA § 1102(b). Therefore, termination assessments may be made only for income and withholding taxes.

Auditors are required to determine if it is appropriate to pursue a jeopardy assessment on all audits based on his or her knowledge of taxpayer operations. In all audits, the letter of comments should discuss facts that were analyzed and state reasons why a jeopardy assessment was either necessary or not. The auditor should discuss the issue and documentation with the RAS before completing the request. The potential dollar liability should also be discussed.

2. Management Review and Approval

Management approval is required before any jeopardy or termination assessment can be issued. **Submission for such assessments is to be treated as top priority**.

The auditor recommending such assessment should complete the following and submit them to their supervisor:

- Form EDA-151 (Jeopardy Assessment Analysis and Request): Can be accessed as a fill-in savable pdf on the Department's Intranet under Work Areas, Audit, Forms.

See Exhibit M for an example of Form EDA-151.

- EDA-8-A (Collection/Legal Action Support): Also accessed as a fill-in savable pdf on the Department's Intranet under Work Areas, Audit, Forms.

    - The EDA-8-A should list owners, responsible parties and assets that a lien can be applied to. The identification and location of

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assets is critical because Collections must have that information to issue the lien.

- audit working papers
- Auditor's Report

a) Auditor Submission

The auditor can personally deliver or use fax or email to submit the package to the supervisor. Justification for the jeopardy assessment must be reasonable and have supporting documentation. A reason of **"I think the taxpayer might leave the state"** is not sufficient to issue a jeopardy assessment. Also, the possibility of a taxpayer closing business as a result of an audit is not sufficient justification for jeopardy assessment.

b) Review and Approval Steps

- If the RAS agrees that a Jeopardy Assessment should be issued, he/she will forward (via UPS, if mailed) the documents to the Assistant Division Manager (ADM) for review. The RAS may also use email, or fax to submit the request to the ADM. Electronic submission is preferred.

- Upon approval, the ADM will forward all documents to Technical Support for review with Legal Services.

- If Legal Services concurs with the issuance of a jeopardy assessment, documents will be presented to the Division Manager for final approval to issue the jeopardy assessment.

- Upon approval, the Division Manager will send all documents to the Tech Review Supervisor.

c) Issuance Steps

- Audit Perfection will post the adjustment information into GenTax, which will establish the assessment. **Perfection will ensure that the 20% UPIA 5 penalty rate is assessed**.

- The Technical Review Supervisor will maintain the approval form and any attachments to include in the audit file once it is received and notify the ADM (copying supervisor and auditor) by email that approval to issue jeopardy assessment has been granted and the assessment has been posted to the system. (If denied, all documents will be returned to auditor for placement, as superseded, in the audit file.)

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- Once notified of Management approval, auditor will print Form IDOR-8-J (Notice of Jeopardy Assessment) and personally deliver it to the taxpayer. This is a notice of demand with payment due immediately.
    - If unable to personally deliver the Notice of Jeopardy Assessment, the auditor should send it via certified mail to the taxpayer's last known address.
    - Form IDOR-8-J is the last notice sent to a taxpayer before a lien is filed. Form IDOR-8-J is available in GenTax, when in the Period View, by clicking on the "Add" tab found when in the "Letter" sub-tab, under the CRM Tab.

[redacted]

See Exhibit N for an example of Form IDOR-8-J.

NOTE: The auditor must NOT print the Jeopardy Assessment Letter until after receiving notification from the Technical Review Supervisor that the audit workpaper adjustments have been posted to the system so that the financial data will pull into the letter correctly.

- **The auditor will complete and print the IL-870, but must not present it to the taxpayer. If the audit is through APT, this would be an EDA-25, not IL-870. The IDOR-8-J contains all the information required by statute to identify the audit liability.**
- A jeopardy assessment indicator and work item will be created at the time the IDOR-8-J is printed and will reside in the Audit Manager to track the jeopardy assessment. The work item will be assigned to the Technical Review Supervisor for monitoring purposes. The Tech Review Supervisor will notify the Collection Bureau via email that a jeopardy assessment has been issued.
- Each different tax type needs a separate jeopardy assessment. The taxpayer has 5 business days (or more as extended by the Department) to comply with the Notice and pay the liability or to show that the findings in the Notice are erroneous. The date that Form

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IDOR-8-J is printed will become the date of notice from which the 5 business days will be counted.

- The auditor should first discuss any taxpayer request for extension with their supervisor, and if the supervisor believes that approval is warranted, the supervisor should discuss the issue with the ADM. If the ADM agrees, the rationale will be presented to the Division Manager. An extension will not be granted unless approved by the Division Manager.

d) Payment of Liability

- If the taxpayer pays the liability within 5 days (or additional time as granted by Division Manager), the auditor must ***immediately*** notify the Technical Review Supervisor of the payment so that the Jeopardy Assessment work item will not be forwarded to the Collection Bureau.
    - The audit payment must be sent to Audit Perfection by utilizing the payment delivery method discussed under Audit Liability Payments and Assessment Collection Payments section. (The Review supervisor will then notify the Collection Bureau by email when payment has been received.)
- The auditor must ***immediately*** complete the audit, and the RAS must ***immediately*** review the file as high priority. Once this is done, the RAS will send (electronically) the file to Technical Review as a paid audit with the audit file clearly marked ('Jeopardy Assessment'). RAS should send an email to the Audit Review RAS listing this as a high priority Jeopardy Assessment. **This will be handled as a priority case.**

e) Non-payment of Liability

- If the taxpayer does not pay the liability within 5 days (or additional time as granted by Division Manager) the Audit Supervisor (or auditor?) must notify the Technical Review Supervisor.
- The Tech Review supervisor will verify that there has been no other taxpayer activity which would stop the issuance of the jeopardy lien. The Tech Review supervisor will then notify the Collection Bureau by email to proceed with the jeopardy assessment lien.
- The auditor must ***immediately*** complete the audit, and the RAS must ***immediately*** review it as high priority. After review, the RAS will send the file (electronically) to Tech Review. The file is to be clearly marked ('Jeopardy Assessment') and **handled as a priority case.** RAS should send an email to the Audit Review RAS listing this as a high priority Jeopardy Assessment.

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XII. AUDIT LIABILITY PAYMENTS AND ASSESSMENT COLLECTION PAYMENTS

The State Officers and Employees Money Disposition Act (30 ILCS 230/2) addresses the requirement concerning all moneys received by the State of Illinois and then paid into the State Treasury. To facilitate this requirement, the following procedures have been implemented.

A. REMITTANCES

(Checks, Drafts or other Paper Instruments)

1. Field Audits

Checks written to cover field audit liabilities **MUST** be mailed directly to Springfield by the taxpayer.

Checks for **INCOME TAX** Audits must be mailed to:

Illinois Department of Revenue
Income Tax Audit Perfection / Notices Section
PO Box 19012
Springfield, IL 62794-9012

The following procedures should be followed concerning the processing of checks:

1) Upon issuance of the IL-870 [EDA-25 if audit completed through APT] or Tax Form to the taxpayer for signature and remittance, the auditor should instruct the taxpayer to send the remittance directly to the appropriate Springfield address (see above).

2) The taxpayer should be provided with a pre-addressed envelope to use for remittance of payment.

3) The auditor must e-mail the Audit Perfection Supervisor providing the following information:

a. Taxpayer Name

b. Account ID

c. Breakdown of the tax, penalty & interest by period/return

d. Expected date for receipt of remittance

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4) Upon receipt of check in Springfield, Audit Perfection Clerical Staff will prepare a payment voucher in GenTax. A copy of the voucher, check and any correspondence received with the check will be sent to the auditor.

5) The check and voucher will be taken to Document Control & Deposit (DC&D) by Audit Perfection Clerical Staff.

The expectation is that taxpayers will remit payment directly to Springfield as outlined above. However, if a check is received by a field auditor or at an IDOR Field office, the check should be mailed to Springfield as indicated above.

a) Overnight Delivery of Checks

(1) Checks Received at the JRTC:

The expectation is that taxpayers will remit payment directly to Springfield as outlined above. However, in the event a payment is received at the JRTC, it should be sent inter-office directly to the WIB using the address below:

Illinois Department of Revenue – WIB
Income Tax Audit Perfection / Notices Section
Mail Code: 3-335

The following procedures should be followed concerning the processing of checks:

1) Upon receipt of check, Audit Perfection Clerical Staff will prepare a payment voucher in GenTax and take to DC&D for processing. A copy of the voucher will be sent to the auditor.
2) The auditor should retain a copy of the check, IL-870, etc. for the audit file.

(2) Checks Received at Field offices other than the JRTC:

The expectation is that taxpayers will remit payment directly to Springfield as outlined above. However, in the event a payment is received at an IDOR Field office, other than the JRTC, it should be sent via **UPS** overnight to the following address:

Illinois Department of Revenue
Income Tax Audit Perfection / Notices Section
Mail code: 3-335
101 W. Jefferson Street
Springfield, IL 62702

The following procedures should be followed concerning the processing of checks:

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1) Upon receipt of check, Audit Perfection Clerical Staff will prepare a payment voucher in GenTax and take to DC&D for processing. A copy of the voucher will be sent to the auditor.

2) The auditor should retain a copy of the check, IL-870, etc. for the audit file.

b) Collection of Outstanding Assessment

It is also the auditor's responsibility to review GenTax to determine if there are any unpaid assessments that need to be collected. The auditor should update the penalty and interest and present the Statement of Customer to the taxpayer to utilize the payment voucher that is part of the statement. See Section VI.A "Statement of Customer – Collection of Assessments" in this chapter for complete instructions. Read the instructions pertaining to outside collection agencies in that same chapter section before generating any Statement of Customer.

The auditor should request that a separate check be issued to cover these assessments. If the auditor is successful in collecting on these assessments, the taxpayer must attach the remittance to the voucher portion (bottom part) of the newly generated updated Statement of Customer and mail to the IDOR address shown on the voucher.

2. In-House Audits and Leads

Checks written to cover a Discovery (In-House) audit or lead liability **MUST** be mailed directly to Springfield by the taxpayer.

a) Discovery Audits

Checks for Discovery audits should be mailed to the following address:

Illinois Department of Revenue
Income Tax Audit Perfection / Notices Section
Post Office Box 19012
Springfield, IL 62794-9012

The following procedures should be followed concerning the processing of checks:

1) Upon issuance of the IL-870 [EDA-25 if audit completed through APT] or Tax Form to the taxpayer for signature and remittance, the auditor should instruct the taxpayer to send remittance directly to the Springfield address indicated above. The address is also on the Notice of Audit Results letter.

2) The taxpayer should be provided with a pre-addressed envelope to use for remittance of payment.

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3) Upon receipt of check in Springfield, Audit Perfection Clerical Staff will prepare a payment voucher in GenTax. A copy of the voucher, check and any correspondence received with the check will be given to the auditor.

4) The check and voucher will be taken to DC&D by Audit Perfection Clerical Staff for processing.

The expectation is that taxpayers will remit payment directly to Springfield as outlined above. However, if a check is received by an auditor, the check should be given to Audit Perfection Clerical Staff for processing.

b) Leads

Most correspondence for leads is systemically generated. Therefore, it is not necessary to provide the taxpayer with the appropriate mailing information. However, if the situation arises where the taxpayer inquiries about how to remit a payment, they should be provided with the address below:

Illinois Department of Revenue
Audit Bureau
Post Office Box 19020
Springfield, IL 62794-9020

The following procedures should be followed concerning the processing of checks:

1) Upon receipt of check in Springfield, Clerical Support will prepare a payment voucher in GenTax. A copy of the voucher, check and any correspondence received with the check will be given to the auditor.

2) The check and voucher will be taken to DC&D by Clerical Support for processing.

The expectation is that taxpayers will remit payment directly to Springfield as outlined above. However, if a check is received by an auditor, the check should be given to Clerical Support for processing.

c) Payment Plan Request

For all in-house Income Tax audit staff - when processing correspondence received from a taxpayer requesting a payment plan, or if the taxpayer has provided a completed CPP-1 form, Payment Installment Plan Request, the below instructions should be followed.

If a request is received with correspondence for a payment plan, there must be one of the following:

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- A Signed IL-870
- A Signed Return, or
- Already assessed liabilities (such as a defaulted NOD).

It is important to first make any adjustment (if necessary) and to verify the taxpayer's contact information (such as address and phone number).

(1) Correspondence Requesting a Payment Plan

When the taxpayer provides correspondence (not a CPP-1 form) requesting a payment plan, the following procedure should be followed to create a work item in GenTax:

1) Open the taxpayer's Account Manager (i.e. BIT or IIT account)

2) Click on "Task" Tab, then the "Work Items" sub-tab. Click on the "Add" tab.

3) Type "Collections" into the green search line, then find "Pay Plan Requested" under *Type* and click on it.

4) Under *Source* select "Audit" from the drop down. The yellow field under *Added* is a required field in which the information from the

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correspondence requesting the pay plan should be entered as a note. Once all information is entered, click on the *Save* button.

5) The request for the pay plan will then appear under the Work Items.

Any handwritten requests that were received from the taxpayer should be placed in the audit file.

(2) Processing a Completed CPP-1 Form

If the taxpayer has completed the CPP-1, Payment Installment Plan Request form, a copy should be made for the audit file and the original forwarded to the Department per the CPP-1 instructions.

Create a work item with a note that the CPP-1 form has been forwarded to Collections.

3. Administrative Hearings, Protest Act & Tax Tribunal

Checks written to cover audit liabilities that are in one of the protest stages above will be handled by Technical Support.

1) Upon receipt of a check, Technical Support will prepare a payment voucher in GenTax. A copy of the voucher, check and any correspondence received with the

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check will be added to the audit file. To add a voucher from the Audit View, click on the “Add Voucher” Tab.

2) The check and voucher will be taken to:
   a. JRTC: Taxpayer Services window
   b. Springfield: Clerical staff in FSE Room

B. ELECTRONIC FUNDS TRANSFER (EFT)

The Department can no longer accept EFT payments in the form of a FEDWIRE (Federal Reserve Wire Transfer). EFT refers to payments not statutorily required under IAC §750.300.

EFT is the transfer of funds, other than a transaction originated by check, draft or similar paper instrument, which is initiated through an electronic terminal, telephone or computer or magnetic tape so as to order, instruct or authorize a financial institution to debit or credit an account (IAC § 750.200).

EFT is an audit payment option. This option is separate and distinct from the requirement for payment of taxes by certain taxpayers using EFT.

There is currently only one EFT option available for taxpayers to submit audit tax liability payments. MyTaxIllinois is the Department’s preferred payment option offered to businesses and individuals who inquire about an electronic payment option.

MyTaxIllinois is accessed via the Department’s website tax.illinois.gov by clicking on the *e-Services* link under *Individuals* or *Businesses*.

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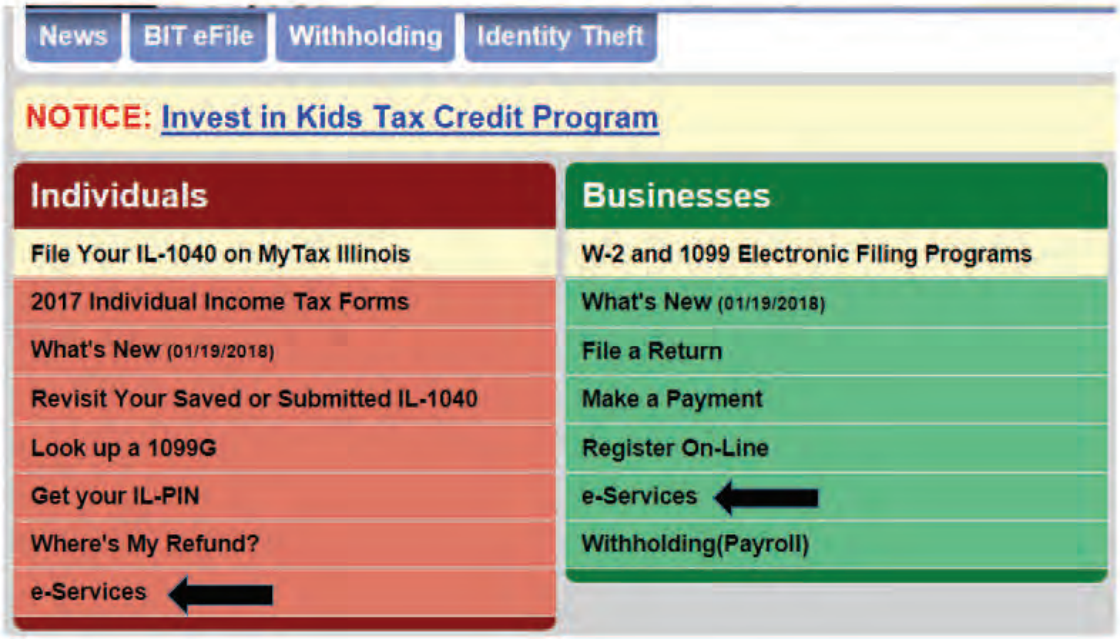

1. MyTaxIllinois

a) Businesses

After clicking on “e-Services” for Businesses, click on the *File, Pay and Manage Your Account Here for the Following* link in My Tax Illinois. Several return types are a pay only option.

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e-Services for Businesses

MyTax Illinois

MyTax Illinois is a centralized location on our website where taxpayers may register a new business or electronically file tax returns, make payments, and manage their tax accounts.

Services provided by MyTax Illinois:

- **Register a Business (REG-1)**
- **Verify a Registered Business**
- **Register for a Bingo, Pull Tabs, or Charitable Games License**
- **Apply for or Renew a Sales Tax Exemption**
- **File & Pay Use Tax (ST-44)** - Should only be used by businesses that are not required to register for sales and use taxes. A taxpayer registered to file Form ST-1 should report any use tax liability on that form rather than Form ST-44.
- **File, Pay, and Manage Your Account Here for the Following:**
  - **Business/Withholding Income Tax**
    - **1099** - (Information Returns)
    - **IL-501** - (Payment Coupon)
    - **IL-505-B** - (Automatic Extension Payment)
    - **IL-516-I & IL-516-B** - (Pass-through Prepayment Vouchers)
    - **IL-941 & IL-941-X** - (Withholding Income Tax Return)
    - **IL-990-T** - (Exempt Organization Income and Replacement Tax Return)
    - **IL-1041** - (Fiduciary Income and Replacement Tax Return)
    - **IL-1065** - (Partnership Replacement Tax Return - **Pay Only**)
    - **IL-1120** - (Corporation Income and Replacement Tax Return - **Pay Only**)
    - **IL-1120-ES** - (Estimated payments)
    - **IL-1120-ST** - (Small Business Corporation Replacement Tax Return - **Pay Only**)
    - **UI-3/40** - (Unemployment Insurance Contribution and Wage Report)
    - **W-2 & W-2c** - (Wage and Tax Statements)
    - **W-2G** - (Certain Gambling Winnings)

The taxpayer should then follow the online instructions for making an electronic tax payment.

b) Individuals

(IL-1040)

After clicking on “e-Services” for Individuals, the screen below appears. Under Make a Payment, the taxpayer needs to click on the MyTaxIllinois link.

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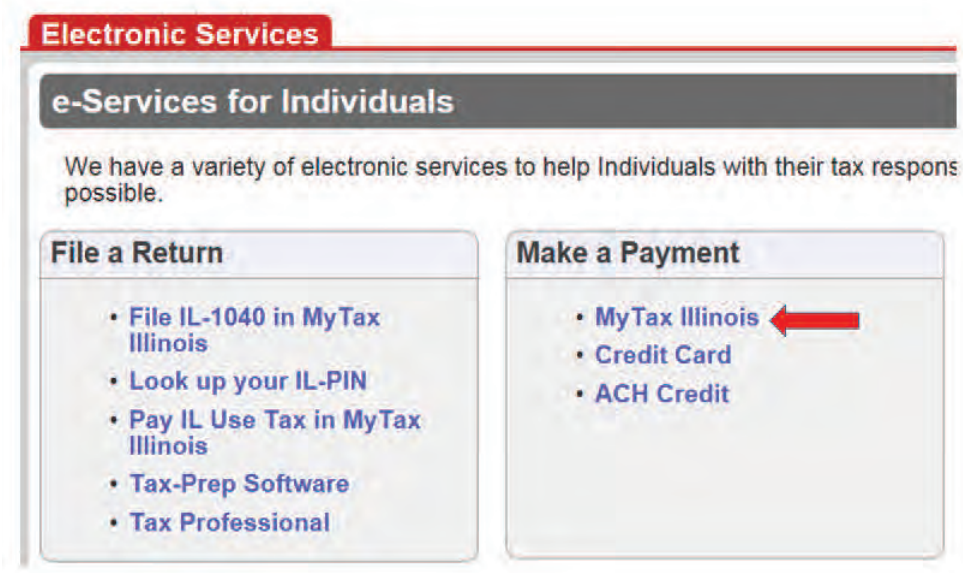

The taxpayer should then follow the online instructions for making an electronic tax payment.

(1) Taxpayer Instructions

When utilizing MyTaxIllinois, the APE for which the audit payment is being submitted may not be available for the taxpayer to select. If this is the case:

- The auditor will instruct taxpayer to post the audit payment to the current year APE.
- The auditor will provide instruction, through an email, to the Electronic Commerce Division to guarantee that the payment is posted correctly once it is transmitted to the Department.

When the taxpayer submits a payment using MyTaxIllinois, the taxpayer needs to immediately provide the auditor with the confirmation number for the payment and the specific APE for which they made the payment.

(2) Auditor Instructions

Provide information for the taxpayer to access payment through MyTaxIllinois.

Explain to the taxpayer that the payment will need to be posted to the current year APE if the payment is being made for an APE or audit period not available on MyTaxIllinois.

Get the payment confirmation number from the taxpayer once the payment

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has been made. This number is needed immediately after the payment is made. Also, get the specific APE for which they made the payment.

The auditor must send an email to the Electronic Commerce Division at rev.taxpay@illinois.gov to guarantee that the payment will post correctly on GenTax. The auditor copies his or her supervisor and the Audit Perfection supervisor when sending the email. The Audit Perfection supervisor will make sure that the payment is posted correctly and that the proper hold indicator is set in GenTax. The email must contain the following information:

- Email subject line: *Audit Payment Submitted on MyTaxIllinois*
- The text of the email:

  Identify the taxpayer: give the taxpayer's name exactly as shown on GenTax, the taxpayer's address, tax type for which the payment is being made (income tax). Provide the account ID and audit track number.

  State the exact amount of the audit payment that was made.

  Provide the confirmation number that the taxpayer received from MyTaxIllinois and gave to the auditor.

  State the APE for which the payment was made on MyTaxIllinois. Also, give the correct APE or audit period to identify where this payment should be posted. If the payment is for multiple APEs, be sure to clearly identify the amounts and APEs to which the payments should be applied.

  Provide contact information (auditor's name, work location and a contact phone number) and request that a reply be sent confirming that the payment has been correctly posted.

  In the audit file, the auditor should provide a copy of the e-mail sent to, and a copy of the response received from, the Electronic Commerce Division.

C. ACH CREDIT

This information moved to Audit Manual Chapter 1.

D. CREDIT CARD PAYMENTS

(Individuals only)

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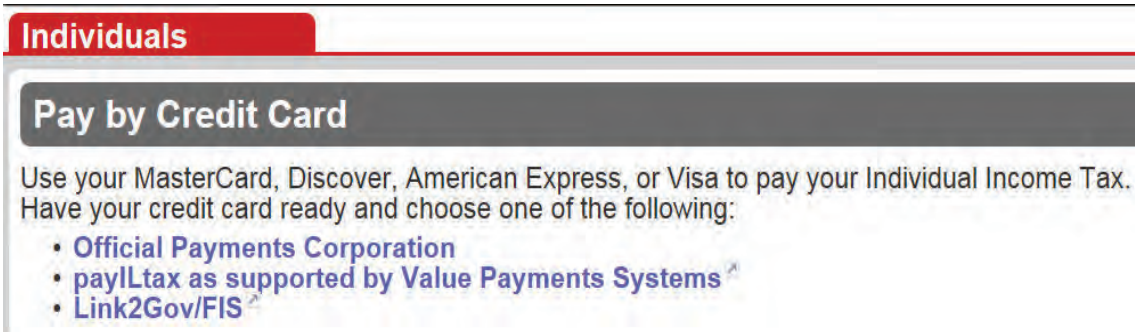
IITA §605 provides that, as of September 24, 1992, the Department may adopt rules and regulations for payment of taxes due under the IITA by credit card.

IL-1040 filers may use VISA, Master Card, Discover, or American Express credit card to pay any individual income tax delinquencies or any prior-year Form IL-1040 return payments starting January 1, 2002. In the Electronic Services section, under e-Services for Individuals, click on the *Credit Card* link:

The taxpayer will then be given three options from which to choose to make a payment.



After choosing an option, the taxpayer will then follow the online instructions for making an electronic tax payment. The credit card service provider will assess a convenience fee.

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XIII. REFERRALS

A. AUDIT REFERRALS USING THE SC-137

Auditors are encouraged to be aware of the level of compliance in their community, and region, as well as on the audits they are conducting. Audit referrals should be made on form SC-137, Audit Referral/Request, and submitted to your supervisor, who should email the SC-137 to REV.G.ITAuditPlanning@illinois.gov.

The SC-137 can be accessed as a savable, printable pdf on the Departments' Intranet under Work Areas, Audit, Forms.

- When referring an unregistered taxpayer, please make sure as much evidence as possible is included with the referral to prove nexus. Copies of invoices, news articles or service contracts are very useful in these situations.

- When submitting the audit referral/request form SC-137, the "reason for referral" section must be completed. Completion is important for Audit Planning to separate non-filers from non-compliance or under-reporters. If "referral for audit" is marked, documentation is required and needs to be attached to the SC-137. A tax potential amount MUST be provided.

Audit Referral Procedures

See Section IV E. – Performing Compliance Checks.

- Non-filed Corporate Income tax returns should be referred to a CIT Supervisor by the Auditor's Supervisor.

- Sales Tax non-filers should be referred to a Sales Tax Supervisor following established referral procedures.

- Withholding tax liabilities should be established following procedures detailed in Chapter 44.

Referrals to IT Discovery

If there are a significantly large number of shareholders, partners or beneficiaries (**ten or more**) not in compliance, the accounts may be referred to the Discovery Section for completion following established referral procedures. A SC-137 needs to be completed for each individual shareholder, partner, etc. and the following documentation attached for each respective situation.

1) Shareholder of an S Corporation

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- Copy of pages 1-4 of the Federal return (US-1120S) filed for each year being referred.
- Copy of K-1 schedules for each shareholder being referred for each year being referred.
- Copy of the IL-1040 return.
- Pro rata share percentage.

2) Partner in a Partnership

- Copy of pages 1-4 of the Federal 1065 return filed for each year being referred.
- Copy of K-1 schedules for each partner being referred for each year being referred.
- Copy of the IL-1040 return.
- Pro rata share percentage.

3) Beneficiary of Trusts or Estates (1041)

- Copy of pages 1-4 of the Federal 1041 return filed for each year being referred.
- Copy of K-1 schedules for each beneficiary being referred for each year being referred.
- Copy of the IL-1040 return.
- Pro rata share percentage.

It will be the Supervisor's responsibility to ensure that all referrals contain the required information stated above. The referrals should then be forwarded to Springfield Audit Planning in an email to REV.G.ITAuditPlanning@illinois.gov for set-up in GenTax.

B. AUDIT REFERRALS TO THE CRIMINAL INVESTIGATIONS DIVISION (CID)

1. Fraud

Fraudulent activity is an INTENTIONAL disregard of the law or the rules and regulations. In order for fraud to exist, the taxpayer must know the correct application of law and must intentionally disregard the correct application of the law in order to reduce or avoid their tax liability. Since fraudulent activity is rarely openly admitted by the taxpayer, proving it usually requires a collection of circumstantial evidence being uncovered in an audit or through a Criminal Investigation Division (CID) examination.

For fraud to exist a taxpayer must generally have caused some monetary harm to be suffered by virtue of his act; and he must have done this believing the consequent injury to the State would not be discovered.

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- The most common fraud consists of acts of omission (e.g., the self-employed taxpayer who simply fails to file returns). In and of itself the failure to file a return may not constitute fraud.

    - However, if it was discovered in the course of the examination, that in several years where tax was withheld, and a refund was due, the taxpayer did file; whereas in other years, when no tax had been withheld, the taxpayer failed to file, a clear and convincing argument that the failure to file constituted fraud might well be made.

    - Similarly, in the case of failure to file by a corporation which had been advised in a previous examination by the Department's auditors of its duty to do so, imposition of the penalty would seem defensible.

The Department has the authority to examine the entire content and substantiation of a federal income tax return as to particular items related to Illinois income tax liability, and to establish a correct federal taxable income. [Ref: IITA § 203(e)] However, audit policy now dictates that the approval process must be followed before any Line 1 adjustments are made. See Section VII.A.1. – Line 1 Adjustments During an Audit.

A taxpayer can, however, properly pay federal income taxes on taxable income and, simultaneously, (utilizing the same numbers reported for federal purposes), defraud Illinois. Possible examples of fraud of this type might include:

- an apportioning corporation that encodes its fixed assets as having other than the true geographic location or allocates "non-business" royalties to states other than the correct ones with intent to mislead the Department on the return itself. Such reallocation or re-categorization in order to persuade the Department that the tax liability as filed is correct could constitute fraud.

No one factor absolutely points to fraud. It is important to remember that mere negligence, or ignorance of law, does not constitute fraud. It must be shown that there was fraudulent intent to evade tax. REF: CCH Para. 40,445.191.

If, during an audit, fraudulent activity on the part of the taxpayer is suspected, the auditor should discuss the case with his/her supervisor. This informal approach will aid in developing a course of action that will best suit the auditor's needs. The informal discussions should be noted on the history worksheet for the case (EDC-5). It is also important in these instances to keep detailed records of all conversations with the taxpayer.

2. Tax Avoidance Verses Tax Evasion

a) Avoidance

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It is also important to understand that there is a difference in a taxpayer evading tax or avoiding tax. Avoidance of tax is not a criminal offense. Every taxpayer has the right to reduce, avoid, or minimize taxes by legal means. The distinction between avoidance and evasion is fine, but definite. The taxpayer that avoids tax does not conceal or misrepresent the facts. He has legally shaped events to reduce or eliminate tax liability and reports these transactions in his records.

b) Evasion

The following is a description of evasion:

> "Evasion on the other hand, involves deceit, subterfuge, camouflage, concealment, some attempt to color or obscure events, or making things seem other than they are. For example, the creation of a bona fide partnership to reduce the tax liability of a business among several individual partners is tax avoidance. However, if the facts of a particular case show that an alleged partnership was not in fact established and that one or more of the alleged partners secretly returned his share of the profits to the real owner of the business, who in turn did not report this income, this would be an instance of evasion." REF: IRS Tax Manual - Para. 12(13).

Example:

Company A owns 100% of Company B. Only Company B is required to file an Illinois return. Company B's 2009 Illinois separate apportionment return reflects an Illinois net loss. For federal purposes companies A and B filed a consolidated return for 2009 which reflected net income. After reviewing the federal return, it was found that all expenses were allocated to Company B on its proforma Illinois return. If it is established that this proration was done merely to evade Illinois Income Tax, the fine line between avoidance and evasion has probably been crossed.

3. Minimum Standards for Criminal Investigation

The following are the minimum standards for criminal investigation initiations and prosecution referrals:

Income Tax –

- Individual Income Tax (IL-1040) and Business Income Tax (IL-1120) failure to file: Minimum of two consecutive years and a minimum of $3,500 in state tax liability per year.
- Fraudulent filing of IL-1040 or IL-1120 returns: Minimum of two consecutive years and a minimum $4,000 state tax liability in the aggregate.
- Illinois Income Withholding Tax (IL-941) failure to file: Minimum of four quarters and $3,500 state withholding tax liability in the aggregate.
- Fraudulent filing of IL-941's: Minimum of two consecutive quarters and $1,500 state tax liability.

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- Failure to pay over IL Withholding Tax: Minimum of $1,500 state tax liability.

NOTE: Exceptions may be sought for tax preparers, tax protesters, or where other specific circumstances are involved that may warrant criminal prosecution.

Tax Protesters

A "tax protester" is someone who refuses to pay a tax on constitutional or legal grounds. Many will claim the tax laws are unconstitutional or otherwise invalid, while some refuse to file a tax return or file returns with no income or tax data supplied (see "frivolous returns" in IITA § 1006 and IAC § 100.5050 – applies only to IL-1040 filers).

- As of July 15, 2010, CID receives IPD referrals for "tax protester" cases and all suspected fraud schemes. CID reviews these referrals to determine if these cases will be pursued. Audit's policy of referrals to CID remains unchanged.

4. Examples of Cases to Send to CID

Examples of matters, if material and relevant, which should be sent to CID for review:

- Inconsistencies between taxpayer books and records and other independent sources of information, such as third-party records or bank information;
- Missing documentation, such as resale certificates or other required forms or schedules;
- Taxpayer is uncooperative or evasive to department employees;
- Taxpayer is proven to be untruthful in statements previously made;
- Other articulated factors by the employee based upon their visual observations and past experience that may indicate fraudulent activities such as knowingly and intentionally underreporting taxable receipts or income; and
- Failure to file and pay tax matters where every reasonable attempt has been made to get the taxpayer into compliance.

5. CID Referrals Form EDA-4

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Form EDA-4, Referral to Investigations, must be prepared for the Audit Supervisor's approval, and then forwarded to the Division Manager.

NOTE: CID reports are confidential and should not be disseminated or included in the audit file. If necessary, the data contained in the report can be included in the auditor's comments, but the report itself should not be submitted with the audit.

a) Preparation/Submission of EDA-4

- The EDA-4 can be accessed on the Department's sp•IDOR web. For this fill-in printable form, go to "Work Areas" and click on "Criminal Investigation Division". Choose "Forms" then click on "Referral to Investigations (EDA-4)". Two copies are required to be printed and signed.

  See Exhibit O – Form EDA-4, Referral to Investigations.

- The "Reasons for Referral" section should contain as much information as possible.

  - If the referral is not related to or does not affect a current assignment, all available information and documentation should be included in this section.

  - If the referral directly relates to a current assignment, this section should include:

    1) Taxpayer's explanation for failure to comply.

    2) Method used in the computation of the liability.

    3) Any legal action which may have already been used such as seizure, demand letter, subpoena, etc.

    4) Information about the taxpayer's records, such as the kind and quality of records kept, who kept the records, etc.

    5) The number of contacts with the taxpayer and the results of those contacts.

    6) Also mention any general observations you have about the business, its management, and employees.

- All copies of the EDA-4 should be signed and dated, and then forwarded to the APTS Supervisor for the Division Manager's required signature.

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- Any correspondence sent via UPS should be sent to: Illinois Department of Revenue, Audit Planning, 101 W Jefferson, MC 3-327, Springfield IL 62702.

- The APTS Supervisor will then forward the EDA-4 to the Division Manager.

b) CID Response

- CID will notify the Audit Supervisor (in writing) of the acceptance or rejection of the referral, generally within 30 days of receipt of the referral, and attach a copy of the EDA-4.

- If no response is received from CID within 25 working days of the referral mailing, the Assistant Division Manager should be contacted by the Audit Supervisor to follow-up with a letter to CID management.

(1) Referral Accepted

If the referral is accepted, CID will request auditor assistance when necessary. All further auditing and investigating activities should be coordinated between the assigned CID agent and the auditor.

(2) Referral Rejected

If the referral is rejected, the reason for rejection will be stated. If additional evidence of fraud is discovered after CID has rejected a referral or has withdrawn from a joint investigation, the case should be referred to CID again.

6. Civil Fraud Determination

If CID rejects the referral to investigate the case for criminally fraudulent activity, the UPIA § 3-6 Fraud penalty (civil fraud) may still be imposed. Upon receipt of such letter, a decision must be made in writing by the Audit Supervisor and/or Assistant Division Manager as to whether to pursue the civil fraud issue based upon the information supplied by the Auditor.

- Authorization to impose civil fraud penalties should generally be granted if the auditor is able to establish that the weight of the evidence will prove:
  1) Material harm was done to the State, by,
  2) A willful act on the part of the taxpayer, with
  3) Intent to defraud the State.

- **Fraud penalties cannot be assessed without approval from the Division Manager.**

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- In all cases where a civil fraud penalty is applied, the evidence contained in the audit must be "clear and convincing" and not just a preponderance of the evidence.
    - According to Black's Law Dictionary, a preponderance of the evidence is "a standard of proof (used in many civil suits) which is met when a party's evidence on a fact indicates that it is `more than likely not' that the fact is as the party alleges it to be". Whereas "clear and convincing proof" is proof that is stronger than a mere preponderance of evidence but not to the extent of such certainty as is required beyond reasonable doubt as in criminal cases. REF: Federal Tax Audit Manual - Chapter 12. (IRM 4(12)20) and Black's Law Dictionary).

In summary, imposition of the UPIA § 3-6 penalty is neither simple nor automatic. While easier to sustain than criminal sanctions, it requires painstaking documentation and extensive investigation efforts to uncover the fraud.

C. AUDIT REFERRALS TO INTERNAL REVENUE SERVICE (IRS)

Pursuant to the Federal/State information exchange agreement, the Illinois Department of Revenue has agreed to forward certain information to the IRS. It is vitally important that we cooperate as fully as possible to fulfill this agreement. The types of information and method of handling such data are stated below and must be adhered to.

Auditors may discover or observe questionable items or practices while in the performance of their duties. For example, a taxpayer may have the following issues:

- under reporting gross sales (receipts) on the US Income tax return;
- deducting questionable items;
- taking too many exemptions; or
- other material issue(s).

If an adjustment affects only gross receipts or sales and Federal Taxable Income or Adjusted Gross Income, the auditor should make the Line 1 adjustment on the Illinois income tax return. However, audit policy now dictates that the approval process must be followed before any Line 1 adjustments are made. See Section VII.A.1. – Line 1 Adjustments During an Audit.

A report is to be made to the IRS by completing federal Form 3949-A, Information Referral (found on www.irs.gov, under Forms and Pubs).

See Exhibit S - Form 3949-A, Information Referral.

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Form 3949-A

Form 3949-A is divided into three sections.

Section A – Information About the Person or Business You Are Reporting - Complete as per instructions provided with form based on whether taxpayer is an individual or a business.

Section B – Describe the Alleged Violation of Income Tax Law - Complete as per instructions provided with form. For Item 5, please be as specific as possible, indicating the year(s) and audit status. Include a copy of any auditor's reports, summary analysis, etc.

The auditor's report should clearly and concisely outline everything that is questionable including dollar amounts, where applicable, and a synopsis of the work completed. Include copies of the audit working papers.

Section C – Information About Yourself

All referrals should be completed as follows for 7a – g:

[redacted], Revenue Audit Supervisor Change for new supervisor
(217) 557-0773
Mon. – Fri., 8:30 a.m. – 4:00 p.m., CST
101 W. Jefferson, MC 3-327
Springfield IL 62702

Send the original form, along with any attachments, to:

Inter-office:
Disclosure Officer
WIB
MC 1-214
101 W. Jefferson
Springfield, IL 62702

UPS:
Illinois Department of Revenue
Disclosure Officer
101 W. Jefferson St., MC 1-214
Springfield, IL 62702

- The form should not be forwarded to the Tax Compliance Disclosure Officer until all Department field action (including fraud investigation and prosecution) is finalized and the case forwarded to the respective central office locations for processing.
- A copy of Form 3949-A along with any attachments should also be included in the audit file.

XIV. TAXPAYER PROTESTS

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This section explains the avenues that a taxpayer has for unagreed audits once a Notice of Deficiency (NOD) or a Notice of Claim Denial (NOCD) are issued.

A. ADMINISTRATIVE HEARING PROTEST

Administrative Hearings is responsible for protests with a liability of $15,000 or less. This $15,000 limit is exclusive of penalties and interest, unless there is no tax liability the total penalties and interest do not exceed $15,000.

The taxpayer should file its written protest by submitting the Form EAR-14, Format for Filing a Protest for Income Tax, accessible on the Department's website. Department procedures are as follows:

- Protest received by Administrative Hearings or Review. If received by Administrative Hearings, will be forwarded to Review
- Review (or if not received by Review, SPI Tech) will attach the Protest to the audit in GenTax
- "Admin Hearing" indicator to be set by Legal
- Review will pass audit to SPI Tech Support
- SPI Tech Support will attach necessary documents to audit in GenTax, change audit stage to "Admin Hearing", and send e-mail notification to Legal

The rules relating to Administrative Hearings can be found in IAC Part 200.

B. ILLINOIS INDEPENDENT TAX TRIBUNAL

The Illinois Independent Tax Tribunal Act of 2012 ("Tribunal Act") was made effective 8/28/12 under P.A. 97-1129, establishing the Illinois Independent Tax Tribunal ("Tribunal"). The Tribunal Act was later amended by P.A. 98-463, effective August 16, 2013.

The purpose of the Tribunal is to give the taxpayers an appeal process with a body independent of the Department. Ref: 35 ILCS 1010/1-5(a).

The criteria for the Tribunal's jurisdiction are as follows:

- Protests filed with respect to:
  - Notices of Deficiency and Notices of Claim Denial where the tax amounts for all notices for the same tax year or audit period exceed $15,000 (not including penalties or interest), or
  - Notices of Deficiency proposing to assess no tax liability and proposing to assess interest and penalty totaling more than $15,000.

For the Tribunal, the taxpayer will have to compose a petition, which the Department will then have to answer, in accordance with 35 ILCS 1010/1-50. See the Tribunal petition guidelines at www.illinois.gov/taxtribunal

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For rules governing the Illinois Independent Tax Tribunal, see 35 ILCS 1010/1-1, *et seq.*, and IAC § 200.102 and 200.175.

Department procedures are as follows:

- Petitions received by Legal from Tax Tribunal, will be forwarded to Review and SPI Tech Support
- Review or SPI Tech will attach the petition to the audit in GenTax
- Tax Tribunal indicator to be set by Legal
- Review will pass audit to SPI Tech Support
- SPI Tech Support will make a copy of the audit file for Revenue litigator, change audit stage to “Tax Tribunal”, and send e-mail notification to Legal

C. CIRCUIT COURT

Taxpayers who wish to forego the Administrative Hearings or Tax Tribunal process may pay the tax due per audit under protest and file suit in Circuit Court. Suit must be filed within 30 days of making that protest payment. The Illinois Compiled Statutes (30 ILCS 230/2a and 2a.1) provide the requirements for payment under protest. Generally, these requirements are:

- Taxpayers must give notice that their payment is being made under protest;
- The notice of protest must express their intention of filing a complaint for injunction or intention of becoming a party to an existing suit;
- The notice must be substantially in the form provided in 30 ILCS 230/2a.1.

The Department's protest payment Form RR-374, Notice of Payment Under Protest, (accessible on the Department’s website) fulfills these statutory requirements. However, a taxpayer's own form of protest may satisfy the requirements if it contains all of the information required by 30 ILCS 230/2a.1.

- If a taxpayer wishes to pay the liability that the auditor has assessed through audit under protest, they should be provided with the RR-374 form. Any monies, which are paid under protest, go into a special "protest" fund and cannot be released into the general revenue fund.
    - A taxpayer that merely writes "protest" or some other indication of protest on the tax return, remittance or in correspondence has not met the statutory requirements.
    - The Department may have to use discretion in determining if a taxpayer has submitted a valid protest. But, in absence of a properly completed RR-374 or other document containing all of the required information, a taxpayer will generally be regarded as not satisfying the requirements for a valid protest.

The protest payments should be accompanied by the RR-374, and the Auditor's Report(s). They should be sent to:

IL Department of Revenue

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Audit Perfection Section
PO Box 19012
Springfield, IL 62794-9012.

Department procedures are as follows:

- Complaint received by the Attorney General's Office will forward to Review and SPI Tech Support
- Protest indicator set by Review
- Review will pass audit to SPI Tech Support
- SPI Tech Support will attach necessary documents to audit in GenTax or make copy of audit file for Revenue Litigator/AG, change audit stage to "Court/Litigation", and send e-mail notification to Legal

XV. PROD-1 AUDIT RESULTS

The PROD-1, Audit Results Report, is used to report the production achieved in the audit. It identifies the area of adjustment (i.e. RAR, NOL, RTIC, etc.), the resolution of the area of adjustment (i.e. agreed paid – AP, established liability – EL, etc.) and the monetary amount of adjustment. The PROD-1 can be accessed as an Excel spreadsheet (version updated 01-31-2018) provided previously in an Audit bureau wide email. This is a standalone PROD-1 that should not be used for audits in APT. Refer to your RAS for access to this standalone spreadsheet, if needed.

Note: This "Excel" PROD-1 should **not** be used for audits that are completed in the CIT package (APT). APT contains its own PROD-1, which should be utilized for those audits completed in APT.

A. PROD-1 COMPLETION

1. General Information

a) Excel Spreadsheet PROD-1

Enter the general information in the upper portion of the PROD-1.

- The taxpayer information should match GenTax information for the name, and the address should be the audit address used during the course of the audit.
- Track number is the GenTax Audit ID – A#######
- ID number is dependent on the tax type as follows:
  - BIT – use the FEIN - ##-#######
  - IIT – use the SSN - ###-##-####
  - WIT – use the FEIN – FEIN-000
  - IL-1023-C – use the FEIN – FEIN-666
  - IL-1000 – use the FEIN – FEIN-555

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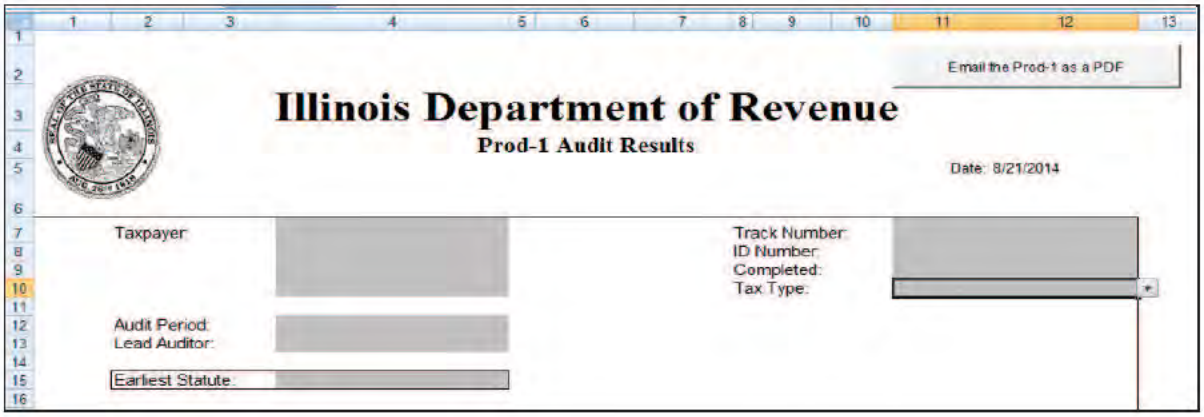
- Completed is the date turned in to the supervisor for review.
- Tax type is a drop-down list, select the correct tax type.
- Audit Period should match the Audit Periods as shown in the Gentax Audit View.
- Lead Auditor is the auditor who completed the audit.
- Earliest Statute – the correct date is vitally important. This date should be the Statute Date as shown in the Gentax Audit View, which should also match the most recent IL-872 on record.



b) APT Self-contained PROD-1

The self-contained PROD-1 in APT can be accessed under the Audit Documents Tab in the tree. Users will click on the PROD-1 document to open for completion.

[redacted]

The lead auditor's name and today's date will fill automatically at the top.

[redacted]

2. Production Codes

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Production codes (see table below) are used in the "AREA" portion of Part 1 – Additional Liability by Period (see subsection (4 ~~a~~) below). The production codes entered in this section show the "cause" of the audit adjustment. This section provides historical statistics that, among other things, are used for future audit selection purposes.

	231 Non-Business Income/ Loss
92 2010 Amnesty Interest- 7/02-6/09	232 IL Partnership Income/ Loss
93 2010 Amnesty Penalty	233 Foreign Insurers
96 Interest- Regular	240 Apportionment Change
97 2003 Amnesty Interest- 7/83-6/02	245 Net Op. Loss Deduction
98 Penalty- Regular	250 Sep. to Combined Apportionment
99 2003 Amnesty Penalty	255 Change to Unitary Members
201 CIT/ IIT Nonfiler	260 WIT Taxes Not Withheld
205 Tax Income Under/ Overstated	261 WIT Taxes Not Paid
206 Federal RAR Change	262 Other WIT Adjustments
210 TEI Addition Modifications	280 IT Credit Change R&D
211 Addition Modification Other	281 IT Credit Change Training
212 Add 80/20 Rltd Party Exp	282 IT Credit Change Coal Res. & Util
213 Add Bonus Depreciation	283 IT Credit Change Jobs
220 Sub. US Govt. Interest	284 IT Credit Change Employee Child
221 Sub. Schedule J	285 IT Credit Change Edge
222 Sub. Federal Nol C/F	286 IT Credit Change Film Prod.
223 Sub. Ent. Zone 1120ST	287 IT Credit Change High Impact Bus.
224 Sub. Personal SRV 1065	288 IT Credit Change Afford. Housing
225 Sub. IL RT Tax 1065	289 IT Credit Change Env. Remediation
226 Sub. Other	290 IT Credit Change IT Investment
227 Sub. 80/20 Part Exp.	291 RT Investment Tax Credit Change
228 Sub. Bonus Depreciation	292 Recapture All Credits
229 Non-Bus Inc. Disallowed	293 Other Adjustments
230 Partnership Inc. Disallowed	

Note: The production code "00" should never be used for Income Tax NL audits. The proper code used should be the cause of the audit adjustment. Example: In the case of an RAR change, use 206.

Production codes 10 to 83 and 100 to 196 are ROT, IFTA, Motor Fuel, and Excise tax codes that are not included in this table but appear in the listing of production codes on the PROD-1.

Amnesty Production Codes

Amnesty production codes listed above are Amnesty Period specific. For the **2003** Amnesty Period, eligible tax periods include the periods after June 30, 1983 and prior to July 1, 2002. Amnesty Interest code 97 was

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used when interest was billed as doubled, and Amnesty Penalty code 99 was used when penalty was billed as doubled.

Production codes for the **2010** Amnesty Program includes the eligible tax periods ending after June 30, 2002 and prior to July 1, 2009. The codes are: 92 for Amnesty Interest and 93 for Amnesty Penalty. These codes must be used for interest and penalty billed on a "2010" Amnesty program period and the liability status will show whether or not the interest and/or penalty is being abated.

3. Liability Status Codes

Liability Status codes are used in both Part 1 (additional liability by Period) and Part 2 (Status of Additional Liability) of the PROD-1. These codes indicate the tax effect (increase or reduction), whether or not the taxpayer agrees, if an original claim has been included in an audit, etc. Also, these codes used on the PROD-1 are to reflect the adjustments to be posted within the audit file.

If the audit assessments are unagreed, then these audits are assigned to the Review section so that the Notices of Deficiency [NODs] or Notices of Claim Denial (NOCDs) are created and issued to the taxpayer within statute.

The following table lists these liability status codes.

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AI	Amnesty Interest (92) & Amnesty Penalty (93) Waived	Used to track the amount of interest and penalty waived during the 2010 Amnesty Program	Dollar amount entered as (+)
AP	Agreed Paid	Additional liability established and paid. The paid amount should be equal to the check amount.	Dollar amount entered as (+)
AL	Agreed (Admitted) Liability	Additional liability established and agreed to by the taxpayer but no payment is provided, OR deemed assessed Penalty & Interest not yet paid for by the taxpayer.	Dollar amount entered as (+)
CL	Claim	Claim established through regular audit and agreed to by taxpayer.	Dollar amount entered as (-)
CR	Claim Reduction	Amount of original claim that has been reduced. Taxpayer disagrees	Dollar amount entered as (+)
EL	Established Liability	Additional liability established without taxpayer agreement	Dollar amount entered as (+)
IR	IT Reduction	IT credit reduction with no tax effect in the current year	Dollar amount entered as (+)
LI	Loss Increase (only for year of loss)	Used when any change that affects the $ amounts above the Net income Line (ex: 2013 IL-1120 Line 39) increases the ILNLD available to be used	Dollar amount entered as (-)
LR	Loss Reduction (only for year of loss)	Used when any change that affects the $ amounts above the Net income Line (ex: 2013 IL-1120 Line 39) decreases the ILNLD available to be used	Dollar amount entered as (+)
NP	Negative/ Positive Change	Positive amount for RC penalties abated	Dollar amount entered as (+/-)
NL	No Liability	No liability established No adjustment necessary	Dollar amount entered as (0)
OC	Original Claim	Amount of original claim filed by taxpayer	Dollar amount entered as (-) or zero
OI	Offset Loss Increase	May be used in conjunction with LI (Loss Increase), or it may be used on its own if there are no changes to the loss year, but the offset to the income year is reduced in audit. Used when reapplying losses to an income year with no tax effect, but there is an increase in the Loss available to be carried going forward after the loss is offset against audit adjustments in the income year.	Dollar amount entered as (-)
OR	Offset Loss Reduction	May be used in conjunction with LR (Loss Reduction), or it may be used on its own if there are no changes to the loss year, but the offset to the income year is increased in audit. Used when reapplying losses to an income year with no tax effect, but there is a reduction in the Loss available to be carried going forward after the loss is offset against audit adjustments in the income year.	Dollar amount entered as (+)
RC	Reasonable Cause	Amount of reasonable cause included in the audit that the taxpayer requested -penalty abatement	Dollar amount entered as (-)
RR	RT Reduction	RT credit reduction with no tax effect in the current year	Dollar amount entered as (+)
WC	Withdrawn Notice/Claim	Used when a taxpayer agrees to withdraw all or part of a claim	Dollar amount entered as (+)

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Note: When entering all dollar amounts, each value should be double checked as to whether a (+) or (-) amount, based on the Liability Status code being used, then entered accordingly.

a) 2010 Amnesty Liability Status Code

With the implementation of the Amnesty Program for 2010, a new status code was required. AI – Amnesty Interest (92) and Penalty (93) Waived – will be used to track the amount of waived interest and penalty during the Amnesty Program. The dollar amount should be entered as a (+).

b) Liability Status Code Rules

Whenever using the Liability Status Codes certain rules should be followed.

- One of the most important is whenever AP (agreed paid) is used for an agreed additional liability, the paid amount should equal the amount paid. When an audit of amended returns is performed, the amount paid with any amended return (not processed) should equal the AP (agreed paid) amount. If the taxpayer pays the audit assessment and does not sign the auditor's reports, code the audit as agreed (AP) and write in the auditor comments that the taxpayer has made the audit payment in agreement for the tax to be deemed assessed. Any related P&I assessments that are not paid are to be coded AL. AL reflects that Notice and Demand(s) are to be issued to the taxpayer for the remaining audit assessment (also deemed assessed).

- Whenever an original claim (OC) exists and the auditor determines that a reduction in the claim is required, either CR (claim reduction) or WC (withdrawn notice/claim) will be used. CR will be used when the taxpayer disagrees with the reduction. If CR, the audit will be assigned to the Review section to issue a Notice of Claim Denial to allow the taxpayer protest rights. WC will be used when the taxpayer agrees with the reduction, and either signs an EDA-153 or letter withdrawing the claim.

- Code AL (agreed liability) would normally be used when additional liability has been established and agreed to by the taxpayer, but no payment is provided. However, Technical Review requests that AL be used only when a "Final Notice of Tax Due" (aka "Notice and Demand") will need to be sent to the taxpayer. When an additional liability is being offset with a pending refund, code CM (credit

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memo) should be used (instead of AL), since a "Final Notice of Tax Due" will not be issued by Technical Review.

- Code NL (no liability) should be used when an audit results with no additional liability due. This is used when the audit will result in a total liability [redacted] for the entire audit period, and this is viewed that the taxpayer is basically in compliance. Code NL should not be used for changes in losses or credits that result in no additional tax due, or if the audit file contains signed amended returns.

- Reminder that the audit late payment penalty (if applicable) should be reflected at 20% (if applicable) on the PROD-1 when the audit is submitted. This normally will be in audits coded EL and on tax periods that have been previously audited regardless of production code if penalty is applicable. Appropriate penalty production codes should be used (93 or 98) based on whether an Amnesty period.

- Protest payments are not shown as PD in production. They should be coded as EL.

- If the taxpayer does not make payment or will not sign for additional audit tax assessment(s), these audits are unagreed (EL) and Notice of Deficiency(s) [NODs] must be issued within statute for these protestable assessments.

- **Audits dealing <u>only</u> with claims for refund or no tax effect amended returns are <u>never</u> to be coded as NL (no liability).**

- If an audit referral is made to income tax (from ROT), the Income Tax audit area will <u>not</u> assess the Negligence Penalty on a taxpayer when the ROT audit did not assess the Negligence Penalty on this same taxpayer. Ref: ABB #2018-2 [effective 4/2/2018].

c) <u>Liability Status Codes in APT</u>

When utilizing the PROD-1 in APT, the following codes apply:

- If the APT 25 the taxpayer signed is the one issued with the 122 using the Jurat statement language, then the 25 is treated just like an amended return and production is "OC".

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- If the APT 25 the taxpayer signed is the one issued with the EDA-143 letter and the IL-870 waiver language, then the production code is "CL".

4. Part 1: Additional Liability by Period

Part 1: Additional Liability by Period

Area: 223 Sub Ent. Zone 1120ST Code: AP Amount: $ 1,300

Total Additional Liability: $ 1,300

Excel spreadsheet PROD-1: Part 1 (Additional Liability by Period) includes drop down lists for both the "Area" field, and the payment "Code" field. When the field is active, a drop-down arrow appears on the right side of that field.

- Click on each drop-down arrow to see the list of available codes.
- Select the appropriate code, then hit the <TAB> key to advance to the payment code field.
- After entering the payment code, hit <TAB> to advance to the "Amount" field.

Part 1 should reflect the audit findings broken down by the "Area" of the adjustment. The auditor will need to verify that the correct code is being used on the PROD-1, since many of the codes have changed. The tab marked "Reference Info" at the bottom of the PROD-1 lists both the old and new codes.

a) PROD-1 Instructions:

Per Audit Management, and for the purpose of tracking production effectively:

1) Do **not net** liability codes reported when there are different applicable area production codes in the audit adjustments. This is essential for data analytics. *Example:* See examples A) and B) under Section "LR – Loss Reduction and LI – Loss Increase" below.

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2) The auditor may only combine liability codes if using the same area production code.
Example: A three-year audit in which the same adjustment (area production code – 228 Sub. Bonus Depreciation) was made in all three years. When reported on the PROD-1, all three years can be combined and reported on one line.

These instructions apply to all PROD-1s available for Income Tax Audit use, which includes: the Excel Standalone, APT and GenTax. With this detailed production information, the newly developed Data Analytics Planning Program will enable Planning to select more productive, focused audit work.

NOTE: All examples illustrated throughout this material are based on the 2014 tax rate (0.095). When determining actual audit production, previous tax year rates may vary.

Definitions

Loss year – A tax period in which the taxpayer has a negative Illinois base income.

Carry year – a tax period in which the taxpayer has Illinois base income, but an excess Illinois net loss deduction from another loss year is carried to the income year to offset it.

b) LR-Loss Reduction and LI-Loss Increase

These LR and LI codes are only to be used on the loss year in which the audit change is made to increase or decrease the loss. They are NOT to be used on the carry year when excess loss is used to offset against a subsequent income year.

(1) LR – Loss Reduction

Loss Reduction production occurs when the year being audited is in a loss state and that loss is reduced, thereby reducing the net loss available to be carried forward. A basic example would be – IL Net Loss beginning is ($500) and after Audit, IL Net Loss is ($400). Production is $100 times the tax rate. Dollar amounts on the PROD-1 need to be entered as a positive amount **(+)**.

PROD-1 Example: The taxpayer's Illinois net loss prior to audit is ($1,000,000). Audit changes to bonus depreciation, non-business deduction, and apportionment reduce Illinois base income to ($500,000). The tax rate is .095. The PROD-1 would look as follows:

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Part 1: Additional Liability by Period

Area:	*228 Sub. Bonus Depreciation*	Code:	*LR*	Amount:	$	*11,875*
Area:	*229 Non-Bus Inc. Disallowed*	Code:	*LR*	Amount:	$	*23,750*
Area:	*240 Apportionment Change*	Code:	*LR*	Amount:	$	*11,875*

NOTE: This LR production is recorded whether the taxpayer agrees by signature or not. An EDA-143LR must be issued to the taxpayer.

(2) LI – Loss Increase

Loss Increase production occurs when the year being audited is in a net loss and that loss is increased, thereby providing the taxpayer with more available net loss to use in the future. A basic example would be – IL Net Loss beginning is ($150) and after Audit, IL Net Loss is ($200). Production is ($50) times the tax rate. Dollar amounts on the PROD-1 need to be entered as a negative amount **(-)**.

PROD-1 Example: The taxpayer's Illinois net loss prior to audit is ($2,000,000). Audit changes to US interest and apportionment increase Illinois base income to ($5,000,000). The tax rate is .095. The PROD-1 would look as follows:

Part 1: Additional Liability by Period

Area:	*220 Sub. US Govt. Interest*	Code:	*LI*	Amount:	$	*(190,000)*
Area:	*240 Apportionment Change*	Code:	*LI*	Amount:	$	*(95,000)*

NOTE: This LI production is NOT recorded without a signed amended return/EDA-25 with waiver statement, indicating agreement, from the taxpayer because the increased loss could result in claims being filed in carry years. If the taxpayer does not provide a signed document for this audit, the production should be changed to NL and the amended return/EDA-25 should be annotated with "Do Not Process".

(3) LR – Loss Reduction and LI – Loss Increase

Example for LR and LI used in the same year –

A) LR amount more than LI amount
PROD-1 Example: The taxpayer's Illinois net loss prior to audit is ($800,000). Audit changes increased income by $100,000, but also increased the Bonus Depreciation subtraction by $25,000. The tax rate is .095. The PROD-1 would look as follows:

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Part 1: Additional Liability by Period

Area:	*205 Tax Income Under / Overstated*	Code:	*LR*	Amount:	*$ 9,500*
Area:	*228 Sub. Bonus Depreciation*	Code:	*LI*	Amount:	*$ (2,375)*
			Total Additional Liability:		$ 7,125

Remember – <u>Since there are two adjustments in this audit for two different area production codes, each must be separately stated</u>. They **<u>cannot</u>** be netted together into one income change line of $75,000 to result in a net $7,125 LR.

NOTE: This production is recorded whether the taxpayer agrees by signature or not because it is an overall reduction to the loss year. An EDA-143LR must be issued to the taxpayer.

B) LI amount more than LR amount
PROD-1 Example: The taxpayer's Illinois net loss prior to audit is ($800,000). Audit changes increased income by $25,000, but also increased the Bonus Depreciation subtraction by $100,000. The tax rate is .095. The PROD-1 would look as follows:

Part 1: Additional Liability by Period

Area:	*205 Tax Income Under / Overstated*	Code:	*LR*	Amount:	*$ 2,375*
Area:	*228 Sub. Bonus Depreciation*	Code:	*LI*	Amount:	*$ (9,500)*
			Total Additional Liability:		$ (7,125)

Remember – <u>Since there are two adjustments in this audit for two different area production codes, each must be separately stated</u>. They **<u>cannot</u>** be netted together into one income change line of ($75,000) to result in a net ($7,125) LI.

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NOTE: This production is NOT recorded without a signed amended return/EDA-25 with waiver statement, indicating agreement, from the taxpayer because it is an overall increase to the loss year which can result in claims being filed in carry years. If the taxpayer does not provide a signed document for this audit, the production should be changed to NL and the amended return/EDA-25 should be annotated with "Do Not Process".

c) OR- Offset Loss Reduction and OI- Offset Loss Increase

The OR and OI codes are only to be used on the carry year in which the audit change is made to increase or decrease the amount of the loss carried to offset against the taxpayer's audited income.

(1) OR – Offset Loss Reduction

This code may be used in conjunction with LR (Loss Reduction), or it may be used on its own if there are no changes to the loss year, but the offset to the income year is increased in audit. It is used when reapplying Losses to an income year with no tax effect, but there is a reduction in the Loss available to be carried going forward after the loss is offset against audit adjustments in the income year. A basic example would be – IL Base Income beginning is $500, ILNLD used is $500, and tax is $0; after Audit, IL Base Income is $600, ILNLD used is $600, and tax is $0. Production is for the change in ILNLD used times applicable tax rate. Dollar amounts on the PROD-1 need to be entered as a positive amount **(+)**.

PROD-1 Example: The taxpayer's Illinois base income prior to audit is $800,000 with $800,000 ILNLD used, so tax is $0. After audit, Illinois base income is $900,000 with $900,000 ILNLD used, so tax is $0. The tax rate is .095. The PROD-1 would look as follows:

Part 1: Additional Liability by Period

Area:	*228 Sub. Bonus Depreciation*	Code:	*OR*	Amount:	*$ 9,500*

NOTE: This OR production is recorded whether the taxpayer agrees by signature or not because it is a reduction to the loss available to be offset to future years. An EDA-143LR must be issued to the taxpayer.

(2) OI – Offset Loss Increase

This code may be used in conjunction with LI (Loss Increase), or it may be used on its own if there are no changes to the loss year, but the offset to the income year is reduced in audit. It is used when reapplying Losses to an income year with no tax effect but there is an increase in the Loss available to be carried going forward after the loss is offset against the audit adjustments in the income year. A basic example would be – IL Base Income beginning is $700, ILNLD

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used is $700, and tax is $0; after Audit, IL Base Income is reduced to $400, ILNLD used is reduced to $400, and tax is $0. Production is for the change in ILNLD used times applicable tax rate. Dollar amounts on the PROD-1 need to be entered as a negative amount **(-)**.

PROD-1 Example: The taxpayer's Illinois base income prior to audit is $800,000 with $800,000 ILNLD used, so tax is $0. After audit, Illinois base income is $600,000 with $600,000 ILNLD used, so tax is $0. The tax rate is .095. The PROD-1 would look as follows:

Part 1: Additional Liability by Period

Area:	***227 Sub. 80/20 Part Exp.***	Code:	***OI***	Amount:	***$ (19,000)***

NOTE: This OI production is NOT recorded without a signed amended return/EDA-25 with waiver statement, indicating agreement, from the taxpayer from the taxpayer because it is an increase to the loss available to be offset to future years which could result in claims being filed. If the taxpayer does not provide a signed document for this audit, the production should be changed to NL and the amended return/EDA-25 should be annotated with "Do Not Process".

(3) OR – Offset Loss Reduction and OI – Offset Loss Increase

Example for OR and OI used in the same year –

A) OR amount more than OI amount

PROD-1 Example: The taxpayer's Illinois base income prior to audit is $800,000 with $800,000 ILNLD used, so tax is $0. After audit, Illinois base income is $900,000 with $900,000 ILNLD used, so tax is $0. However, audit changes increased income by $125,000, but also increased the Bonus Depreciation subtraction by $25,000. The tax rate is .095. The PROD-1 would look as follows:

Part 1: Additional Liability by Period

Area:	***205 Tax Income Under / Overstated***	Code:	***OR***	Amount:	***$ 11,875***
Area:	***228 Sub. Bonus Depreciation***	Code:	***OI***	Amount:	***$ (2,375)***
				Total Additional Liability:	**$ 9,500**

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Remember – Since there are two adjustments in this audit for two different area production codes, each must be separately stated. They **cannot** be netted together into one income change line of $100,000 to result in a net $9,500 OR.

NOTE: This production is recorded whether the taxpayer agrees by signature or not because it is an overall reduction to the amount of loss available to offset to future years. An EDA-143LR must be issued to the taxpayer.

B) OI amount more than OR amount
PROD-1 Example: The taxpayer's Illinois base income prior to audit is $800,000 with $800,000 ILNLD used, so tax is $0. After audit, Illinois base income is $700,000 with $700,000 ILNLD used, so tax is $0. However, audit changes increased income by $25,000, but also increased the Bonus Depreciation subtraction by $125,000. The tax rate is .095. The PROD-1 would look as follows:

Part 1: Additional Liability by Period

Area:	*205 Tax Income Under / Overstated*	Code:	*OR*	Amount:	$	2,375
Area:	*228 Sub. Bonus Depreciation*	Code:	*OI*	Amount:	$	(11,875)
			Total Additional Liability:		$	(9,500)

Remember – Since there are two adjustments in this audit for two different area production codes, each must be separately stated. They **cannot** be netted together into one income change line of ($100,000) to result in a net ($9,500) OI.

NOTE: This production is NOT recorded without a signed amended return/EDA-25 with waiver statement, indicating agreement, from the taxpayer because it is an overall increase to the loss available to be offset to future years which could result in claims being filed. If the taxpayer does not provide a signed document for this audit, the production should be changed to NL and the amended return/EDA-25 should be annotated with "Do Not Process".

d) Multi-year Audit Example Using New Codes

Basic Example:

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Year 1: IL net loss beginning is ($500) and after Audit, IL net loss is ($400) – LR
Year 2: IL Base Income beginning is $500, ILNLD used is $500, and tax is $0; after Audit, IL Base Income is $600, ILNLD used is $600, and tax is $0 – OR
Year 3: IL Base Income beginning is $700, ILNLD used is $700, and tax is $0; after Audit, IL Base Income is $650, ILNLD used is $650, and tax is $0 – OI.

PROD-1 Example:
Year 1 (2012): The taxpayer's Illinois net loss prior to audit is ($800,000). After audit Illinois net loss is ($400,000). Audit changes were to bonus depreciation of ($100,000), non-business deduction of ($200,000), and apportionment $100,000. The tax rate is .095.

Year 2 (2013): The taxpayer's Illinois base income prior to audit is $700,000 with $700,000 ILNLD used, so tax is $0. After audit, Illinois base income is $900,000 with $900,000 ILNLD used, so tax is $0. Audit change was to the subtraction modification for US Govt. Interest. The tax rate is .095.

Year 3 (2014): The taxpayer's Illinois base income prior to audit is $800,000 with $800,000 ILNLD used, so tax is $0. After audit, Illinois base income is $700,000 with $700,000 ILNLD used, so tax is $0. Audit change was to the subtraction modification for 80/20 Party Expenses. The tax rate is .095.

Part 1: Additional Liability by Period

Area:	228	*Sub. Bonus Depreciation*	Code:	*LR*	Amount:	$	*9,500*
Area:	229	*Non-Bus Inc. Disallowed*	Code:	*LR*	Amount:	$	*19,000*
Area:	240	*Apportionment Change*	Code:	*LR*	Amount:	$	*9,500*
Area:	220	*Sub. US Govt. Interest*	Code:	*OR*	Amount:	$	*19,000*
Area:	227	*Sub. 80/20 Part Exp.*	Code:	*OI*	Amount:	$	*(9,500)*
					Total Additional Liability:	$	47,500

NOTE: In a multi-year audit, if there is an LR or OR code, an EDA-143LR must be issued to the taxpayer. Also, if in an individual year within a multi-year audit, there is an LI or OI code, then this production is NOT recorded without a signed amended return/EDA-25 with waiver statement, indicating agreement, from the taxpayer because it is an overall increase to the loss available to be offset to future years which could result in claims being filed. If the taxpayer does not provide a signed document for that respective year [LI or OI] in this audit, the production would not be recorded and the amended return/EDA-25 should be annotated with "Do Not Process".

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5. Part 2: Status of Additional Liability

Part 2: Status of Additional Liability

Code:	AP	Amount:	$ 1,300
		Total Additional Liability:	$ 1,300

Excel spreadsheet PROD-1: Part 2 (Status of Additional Liability) is completed like Part 1 by using the drop-down arrow for the "Code" field. Note that the auditor must enter the appropriate liability code on each line in Part 1 and Part 2. Also, the amounts entered in Part 1 and 2 must match, and the **total of each** liability code in Part 1 will be entered for that code in Part 2.

6. Comments and Signatures Section

A "Comments" section allows the auditor to type in comments without having to "unprotect" the PROD-1. The comment section appears as follows:

Comments: Add comments here pertaining to the audit.

Auditor Signature Date Supervisor Signature Date

Per ABB #2018-3 [effective 5/16/2018], the policy concerning signatures on the PROD-1 has been changed. Signatures of the auditor and audit supervisor are no longer required on the PROD-1. In lieu of signatures, the following process must be followed:

- The auditor completes the PROD-1
- The auditor attaches the PROD-1 in the Electronic Documents folder in GenTax and changes the stage to RA Supervisor Inventory when ready to submit the audit to their supervisor for review. Attaching the PROD-1 and changing the stage is proof that the audit was completed/approved by the auditor in lieu of the signature on the PROD-1.
- The audit supervisor downloads and reviews the PROD-1 for accuracy and correctness.

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- The audit supervisor changes the stage to Passed to Clerical when the audit has been thoroughly reviewed and has been approved. The downloading/review of the PROD-1 and changing the stage is proof that the audit was reviewed/approved by the supervisor in lieu of the signature on the PROD-1.
- If the PROD-1 is not correct or accurate, the supervisor must return the audit to the auditor to correct this document.

Email the Prod-1 as a PDF

Illinois Department of Revenue

Prod-1 Audit Results

Date: 3/30/2015

Taxpayer	*Ima Taxpayer* *101 W Jefferson Street* *Springfield IL 62702*	Track Number ID Number Completed Tax Type	*A123456789* *12345-67890* *3/30/2015* *1120-ST*
Audit Period Lead Auditor	*01/01/2012-12/31/2012* *John Doe Auditor*		
Earliest Statute	*10/15/2015*		

Part 1: Additional Liability by Period

Area	Code	Amount
223 Sub Ent. Zone 1120ST	*AP*	$ *1,300*
	Total Additional Liability	$ 1,300

Part 2: Status of Additional Liability

Code	Amount
AP	$ *1,300*
Total Additional Liability	$ 1,300

Comments: Add comments here concerning the audit.

Auditor Signature Date Supervisor Signature Date

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This PROD-1 can be e-mailed using the "Email the PROD-1 as a PDF" button found in the upper right-hand corner. This button is mainly for use by supervisors who need to forward a copy of the PROD-1 to staff who update production info.

7. APT PROD-1 Codes

To enter the codes in APT, users need to double click on the blank line, scroll down and choose the appropriate codes. Dollar amounts are manual entry fields. The comment section is also available if needed.

Users need to be aware that unlike previous versions of the PROD-1, the display of the APT PROD-1 will be in a two line per entry format. Example follows.

Part 1: Additional Liability by Issue

Area: 98 - Penalty			
	Code: EL - Established Liability	Amount	5,000
Area: 211 - Addition Modification Other			
	Code: EL - Established Liability	Amount	100,000
		Total:	105,000

Part 2: Status of Additional Liability

	Code: EL - Established Liability	Amount	105,000
		Total:	105,000

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8. Viewing the PROD-1 Results in GenTax

Information submitted on the PROD-1 is entered into GenTax by clerical staff in the Technical Review/Perfection section. The codes can be found in the Audit Manager under the *Audit* tab, *Working Papers* sub tab, Production/Hearings working paper type as shown through the screen print below.

Click on the *Working Papers* ID number to access the Production & Hearings detail.

XVI. DEADLINE TO TURN IN AN AUDIT

A Waiver of the Statute of Limitations for issuance of a Notice of Deficiency must be obtained no later than 2 **months** (60 days) prior to the expiration of the statute. This applies to all Income Tax audits.

If waivers cannot be secured by the above date, ALL audits (agreed and unagreed) must be transmitted to Technical Review. The audit file tracking procedures in Section XXI should be followed. The manager of Technical Review should be notified, in writing or by e-mail, if an unagreed case is pending with a running statute along with an expected arrival date for the case in Review.

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TIMELINE FOR SUBMITTING AN AUDIT WITH STATUTE DATE

The following timeline chart examines various segments that affect audit completion, with the minimum amount of time for completion being nine months.

	Months
All audits must be submitted with 2 months on statute (OP 92-002 & 92-003)	**2.0**
RAS has up to 30 days to review completed audit (OP 92-002)	**1.0**
IL-870 – has 30 days to expire	**1.0**
EDA-122 and EDA-125 – have 60 days to request ICB	**2.0**
Preliminary audit results – 30-day deadline for taxpayer to review	**1.0**
Minimum amount of time to begin audit completion	**7.0**

Note: This timeline does not account for any time to transmit audits to your RAS or time to revise any documents if additional information is received from the taxpayer that impacts the audit conclusion.

The taxpayer can sign a waiver any time during this process to provide additional time for submitting the audit.

If the taxpayer's ICB request is accepted, once the recommendation is issued a new statute date may exist.

XVII. ASSEMBLING THE AUDIT FILE FOR SUBMISSION

Note: For submission of Electronic Audits, refer to the section on Electronic Audits in Chapter 2, General Audit Procedures.

Before submitting the paper audit for review, the auditor needs to properly assemble all of the documents contained within the audit. To aide in this assembly, the EDA-51, Income Tax Audit Index, should be completed and used as a guide for determining the order of documentation within the audit file folder.

- **See Exhibit P (For audits not completed in APT: #1 – the EDA-51 used by field auditors and #2 – the EDA-51 used by in-house auditors. For audits completed in APT: #3 – the EDA-51 contained in APT)** at the end of this chapter.

  There are other EDA-51s available:
  1) the EDA-51-WIT, used in withholding audits. See Chapter 44 for information on Withholding and the EDA-51-WIT.

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2) the EDA-51-IIT, used in individual income tax (IL-1040) audits. See Chapter 45 for information on these audits and the EDA-51-IIT.

Note: When using the CIT package (APT) for an audit, the EDA-51 available through that package must be used, as opposed to previous EDA-51 versions.

XVIII. AUDIT SUBMISSION AND REVIEW

Note: For submission of Electronic Audits, refer to the section on Electronic Audits in Chapter 2, General Audit Procedures.

A. SUBMISSION

1. Agreed Audits

"Agreed Audits" must be submitted to the supervisor for review within **15 days** of auditor notification of receipt of the payment voucher or receipt of signed return, or signed IL-870 "Waiver of Restrictions", whichever is later.

2. Unagreed Audits

"Unagreed Audits" will be discussed with the supervisor prior to submission. "Unagreed Audits" must be submitted to the supervisor for review within **15 days** of the expiration date of the IL-870 "Waiver of Restrictions".

3. No Liability Audits

"No Liability" audits must be submitted for supervisor review within **15 days** of finalizing casework.

Note: If an auditor cannot submit the audit as outlined, the auditor must notify the audit supervisor and include rationale stating why they could not comply within these dates.

B. REVIEW

Supervisor Review of Submitted Audits

In-house and field supervisors are expected to review completed audits and either approve them or return them to the auditor for correction, within the time frame established in the Management Expectations.

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Audits Returned by Revenue Audit Supervisor

All completed audits returned by the Revenue Audit Supervisor to the auditor must be treated as a priority by the auditor and returned to the supervisor within **15 days** of receipt.

XIX. CONTINUING AUDIT FILE

Audits initiated after October 31, 2017:

The audit will be "paperless", an electronic audit stored in GenTax and accessed on the Audit Springboard under the CRM Electronic Documents tab. This audit documentation will now be stored in GenTax. See Audit Manual Chapter 2 for information on Electronic Audits.

Audits for tax years 2011 and prior to November 1, 2017:

The Continuing Audit File (CAF) is stored electronically in a network storage area (Tiamat). The purpose is to have a complete copy of the audit file and associated workpapers available electronically for future use (e.g., copies for administrative hearing, original audit file missing, etc.). Superseded workpapers should not be included. If these items need to be referenced at a later time, the audit may be ordered from Records Management in Springfield.

- A paper copy of the CAF identical to the electronic CAF may be kept in the respective field office at the auditor's discretion for future audits. Under no circumstances are they to be retained at the auditor's home.

The network storage area is designed so that each auditor has full rights to all files stored in Tiamat. Supervisors have full rights to each of their auditors' folders. The Audit Review, IT Audit Technical Support, and Computer Support personnel have full access to these folders as well.

Upon completion of the audit, it is the auditor's responsibility to store the required audit documents in the network storage area and to clear the audit from their laptop and/or desktop computers. Supervisors will be responsible for reviewing the audit folders.

Network storage is NOT replacing the paper audit file. Any audit documentation on paper should continue to be turned in with the paper audit file for these specific tax years.

Audits for tax years prior to 2011:

A paper CAF is the only available resource for those years.

A. NETWORK STORAGE INSTRUCTIONS

All auditors have a folder located on \\tiamat\sys\audits\users. All auditors (field and in-house) are required to save audits to the network location.

See Exhibit Q – How to Save Audits to the Network.

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Documents with taxpayer's original signatures on them should be included in the electronic CAF; such as but not limited to signed IL-870's and Waivers of Statute of Limitations. These documents should be scanned into the respective audit file and loaded into the CAF.

WARNING: YOU SHOULD STILL BACK UP YOUR IN-PROGRESS AUDITS ONTO A DEPARTMENT ISSUED ENCRYPTED FLASH DRIVE AS WELL AS ON THE HARD DRIVE. THIS IS YOUR ONLY PROTECTION IF YOU LOSE THE HARD DRIVE IN YOUR COMPUTER.

B. AUDIT REVISIONS

1. Prior to Protest

Revisions made to documents by field auditors or in-house auditors should be saved so that the new version ***overwrites*** the already saved version.

2. After Protest is Finalized

For audits forwarded to Administrative Hearings, Court or Independent Tax Tribunal, any revisions to auditor reports after they have entered this process will need to be saved as a separate document by IT Audit Technical Support.

C. VIEWING AN AUDIT IN STORAGE

1. Field Auditors

Once an audit is in storage, the auditor may need to view that audit information. The following provides the steps for viewing that audit:

- Go to your storage folder
- Right-Click on the applicable track to be viewed
- Left-Click on "Copy"
- Go to "Computer"
- Double-Click on the C: drive
- Double-Click on CIT audits
- Right-Click on an empty space
- Left-Click on "Paste"

2. In-House Auditors

- Go to your storage folder
- Double-Click on the applicable folder

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D. REQUIRED DOCUMENTS

1. Income Tax

The following is a list of items (not all-inclusive) that are required to be included in the electronic CAF of all audits, if applicable to your audit:

- IL-872 Consent to Extend the Statute of Limitations (signed)
- ICB Action Decision
- EDA-51 Income Tax Audit Index
- Prod-1 Production Results
- IL-870 Waiver of Restrictions (signed)
- EDA-64 Auditor's Comments
- IL-2848 Power of Attorney
- Schedule UB
- CIT Schedules – apportionment factor details
- EDA-27 Explanation of Adjustments
- Auditor's Reports (EDA-24, EDA-25, etc.)
- Penalty and/or Interest Computations
- NOL Schedule (Verified Exported Excel NLD spreadsheet from GenTax)
- EDC-5 Taxpayer History Worksheets
- EDA-70 Information Document Requests
- 404 adjustment computations
- EDA-8 Collection/Legal Action Support
- Supporting Schedules from Federal Returns
- EDA-132 Unitary Determination Questionnaire, if applicable
- Word documents
- Excel spreadsheets created by the auditor
- Taxpayer correspondence

Note: Additional documentation that is pertinent to the audit may also be included in the electronic CAF. If warranted, documentation may need to be scanned and saved as pdf files.

2. Income Tax Discovery

Discovery leads generated from the GenTax Discovery program are saved within GenTax and are not required to be saved in the auditor's network storage folder. Work papers, spreadsheets, non GenTax word documents, etc. are to be saved as attachments to the lead in GenTax.

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E. TIAMAT ACCESS

Auditors have access to all files stored in Tiamat, which should be audits prior to November 1, 2017. This is important when needing to access taxpayer tax information [CAF] from a previous audit (but completed by another auditor) that may be pertinent to the current audit.

CAF Requests (For Audits in Tiamat)

1. Open the closed audit from the Business account manager, Audit tab, click on "Show History" tab. Click on hyperlink of the audit requested.

2. Note Audit ID and look in audit history for the auditor who performed the audit.

3. Go to \\tiamat\sys\Audits\Users\.

4. Click on folder of the auditor for the CAF requested.

5. Search the auditor's folder for the Audit ID and/or taxpayer's name and audit period of the CAF requested.

6. When found, highlight the file, right-click the mouse, select "Copy"

7. Open the requesting auditor's folder on \\tiamat\sys\Audits\Users\.

8. Right-click the mouse while hovering in the white space to the right of the file list, select "Paste".

Form IDR-229, Uniform Audit Action Request, is not required to be completed/submitted when copy/pasting such files. The IDR-229 would only need to be completed/submitted if needing access to "old" taxpayer forms not stored in Tiamat – in which case, mark the box "Request for Data" on the form. Form IDR-229 (a savable fill-in pdf) is available under Forms in the Audit Work Area on the sp●IDOR web. The completed IDR-229 would need to be emailed to REV.G.ITAuditPlanning@illinois.gov.

XX. THE QUALITY AUDIT

Audits pass through a series of steps after they are transmitted to Audit Perfection for approval and processing to ensure that they are completed properly. When the audit is received in Technical Review, it is assigned to an RTS. The RTS performs an initial review of the audit. The RTS verifies that audit processing documents and schedules are complete and correct,

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workpapers supporting audit adjustments are included, payments are correct, and there are no computational errors.

The audit then advances to the second stage of review where it is assigned to an Audit Reviewer. The reviewer, who is a Revenue Auditor, then analyzes the audit to make sure that all audit issues have been checked and that the law has been properly applied. There are several general areas of concern to the reviewer.

- Did the auditor apply the law properly, are the computations correct, and is the report clear, concise and meaningful?

- Have approved versions been utilized for all audit forms and workpapers? There will be instances where standard generic computer spreadsheets will not work for audit scheduling purposes. Customized spreadsheets can then be made from Excel.

XXI. RETURNED AUDITS

The main purpose and responsibility of Technical Review is to evaluate every audit for quality and completeness and to issue Statutory Notices ~~a~~ [Notice of Deficiency (NOD) or Notice of Claim Denial (NOCD)] that they feel can be upheld at the Administrative Hearings, Tax Tribunal, and/or Circuit Court level. Auditors who are contacted by Technical Review regarding an audit they have completed, should understand that the reviewer/analyst's intention is not to create more work for the auditor but, rather, to improve the quality of the audit being transmitted. In this way the Audit Bureau will continue to pursue the goals of the Department's Mission Statement which include establishing clear, concise, accurate and timely communications with the public and to maintain a work force that demonstrates the highest standards of integrity, efficiency and performance.

Note: Audits must be transmitted to Technical Review/Audit Perfection (TR/AP) prior to the 60 days deadline for securing an IL-872 by the auditor. Once in TR/AP, if the audit then falls within the 60 days statute date period prior to processing being completed, TR/AP is responsible for securing an IL-872.

> Example: An audit was transmitted to TR/AP with six months left on the statute (well within the 60 days deadline). When processing has not been completed yet with 60 days left on statute, TR/AP is responsible for securing an IL-872.

Occasionally errors are discovered by Technical Review that can be corrected in-house. In this case, an email will be sent to the Auditor and Supervisor as an "advisory", which will explain any corrective action taken before processing the audit.

If the audit cannot be corrected in-house, it will be returned for revision. Any transfer (or movement) of an audit must follow the guidelines established in the Audit File Tracking Procedures (see next Section). For Paper Audit Files (although, obsolete as of October 31, 2017):

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- The reviewer creates a Working Paper in GenTax for the audit to be returned to the field.
- Reviewer gives the audit file to the Tech Review Supervisor.
- Audit file is sent to auditor or RAS
- Auditor corrects audit and adds Response on Working Paper in GenTax
- Auditor prints comments page to place in the audit file and sends to Audit Supervisor
- Audit Supervisor enters comments that they are approving the response
- Audit Supervisor sends e-mail to the Tech Review Supervisor and reviewer that file is being returned
- Auditor places an 8 ½ x 11 paper on front of audit file with reviewer's name so file gets back to reviewer.

For Electronic Audits:

- The reviewer creates a Working Paper in GenTax for the "audit" to be returned to the field for correction.
- Notification of this "returned audit" will happen through an email that is initiated out of GenTax when stage is changed.

Audits Returned by Audit Review & Perfection (AR&P)

Returned audits must be handled as a priority.

1) Returned audits not requiring additional contact with the taxpayer must be answered and resubmitted to the supervisor within **15 days** of the notification.

2) Returned audits requiring audit changes and taxpayer contact require that contact with the taxpayer must be made within **15 days** of the notification from AR & P. The returned audit should be resubmitted to the supervisor within **15 days** of all completed changes.

3) Supervisors must review the returned audit within **15 days** of receipt from the auditor and, if correct, return to AR & P.

XXII. AUDIT FILE TRACKING

Audit File Tracking applies to ALL audit staff (field and in-house). The ability to track audit files is essential since these files may contain Federal Taxable Information (FTI). This FTI may be actual documentation received from the IRS or co-mingled information that appears on printed

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GenTax screens included in the audit file. Therefore, GenTax screens should be printed sparingly.

To ensure the audits can be properly tracked, an email trail is essential. Note that an email is **in addition to** the appropriate changes that are required to be made in the GenTax through the Audit View. Generally, any time the audit is transmitted from one Audit employee to another, two emails will be initiated. One will be sent from the sender to the intended recipient. The second will be sent from the recipient back to the sender once the audit has been received. Each email should contain the following for each audit being transmitted:
(1) name of the taxpayer
(2) audit track number
(3) tracking number, if available when mailed by UPS.
(4) expected delivery date, if mailed by UPS.

The email trail should be as follows:

A. COMPLETED AUDITS RECEIVED FROM FIELD

a. When an auditor submits the audit (paper audit) to their supervisor, they need to send an email indicating the date that it is being submitted or delivered (either physically or by UPS) to that supervisor. If the audit is being sent UPS to an office, the clerical that handles the office mail should be “copied” on that same email.

b. Once the audit is received by the supervisor, a reply email should be sent back to the auditor as confirmation that the supervisor is now in possession of the audit.

c. Upon receipt of a completed audit, supervisors are to review the completed audit, and either forward it to the appropriate Audit clerical staff for processing or return the audit to the auditor for correction(s), within the time frame established in the Management Expectations. In either case, the supervisor must email the appropriate person (either the auditor or the clerical staff) that the audit is being returned/forwarded on a given date. Attached to the email should be the scanned transmittal. See Audit Manual Chapter 1 for information on transmittals.

d. In turn, the auditor or the appropriate Audit clerical staff would email back to the supervisor when they have received that particular audit.

e. If the completed audit passes supervisory review, the supervisor must follow staging, etc. procedures.

B. REVIEWED AUDITS THAT NEED CORRECTED

a. When the Technical Review Supervisor determines that an audit needs to be returned to the auditor for correction, the supervisor must email the reviewer,

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auditor, auditor supervisor, Assistant Division Manager, and Division Manager providing notice that the audit is being returned for correction (and the date that it is being returned). Attached to the email will be the Excel file that the reviewer had prepared.

Audits (paper audits) being returned to the field can now be sent directly through the Department of Revenue's mail room. Also, when returning an audit, please do not send via certified mail due to the Department's policy to eliminate certified mailing costs. Returned audits **must** be sent via UPS.

Note: Audit Review in Sales Tax rarely mails back audits for correction to the field. Most are now sent electronically as an email with the Excel file attached for correction.

b. Once received back for correction, the auditor and/or supervisor should email that the returned audit is now in that person's possession. After corrections are made, the audit will be submitted back to that auditor's supervisor for approval. Again, an email will be required when submitting the corrected audit back to his/her supervisor.

c. The supervisor must email the auditor when the audit has been received back with the corrections. Once corrections are approved by the supervisor, the Audit supervisor should notify (e-mail) the Technical Review Supervisor (and the personnel listed in (a) above) that the file is being returned. The file should contain a copy of the response that the auditor entered in GENTAX. The auditor should place an 8 ½ x 11 sheet of paper in the front of the audit file with the Reviewer's name plainly printed so that the file gets back to the reviewer and does not end up mixed in with new inventory.

d. Once the corrected audit is received back in house, an email should be sent to the field supervisor stating that the corrected audit was received.

C. MAILING OF AUDITS TO REVENUE OFFICES

This information moved to Audit Manual Chapter 1.

D. AUDIT MOVEMENT BETWEEN REVENUE OFFICES

This information moved to Audit Manual Chapter 1.

E. DETERMINATION THAT AN AUDIT FILE IS MISSING

This information moved to Audit Manual Chapter 1.

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F. AUDIT TRANSMITTAL FORM IN GENTAX

This information moved to Audit Manual Chapter 1.

XXIII. CORRESPONDENCE RECEIVED AFTER AUDIT CLOSURE

Situations may arise in which correspondence is received after an audit has been closed. The two most common types of correspondence that might be received are:

- Reasonable Cause (RC) request – see Audit Manual Chapter 2, General Audit Procedures, for additional information
- Requesting explanation of P&I billed

In-house auditors will receive the actual work item, while field auditors will be informed by email (no physical work item). Work items can be seen in GenTax, under the Task tab and Work Items subtab.

The following steps should be used for an RC request:

- The auditor should check the CAF (either in GenTax or Tiamat dependent on tax year) to see if a previous RC request was addressed during the audit.
  - If yes, but the request had been denied, the taxpayer should be informed that: 1) RC was previously denied and 2) the BOA process would be available. Taxpayer should be sent a Free Form letter stating such information.
  - If no, but the taxpayer has already agreed to the audit with payment of the tax liability, the taxpayer should be informed of the BOA process. Taxpayer should be sent a Free Form letter stating such information. In-house auditors should print a copy of the Free Form letter to attach with the physical work item, which will be closed and sent to files.

The following steps should be used for an explanation of P&I billed:

- Auditors (both in-house and field) should review the audit P&I calculations, then send a Free Form letter to the taxpayer with an explanation as to the billed P&I.
- Example of this situation is the taxpayer paid the tax, penalty and interest shown on the IL-870 later than 30 days after issuance. The bill is most likely the additional 5% penalty and interest amount is the accrued interest from date of issuance of the IL-870 and the date the payment was received.

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XXIV. EXHIBITS

A. EXHIBIT A - HOW TO SEARCH FOR UNITARY MEMBERS

1. Schedule UB Changes in GenTax

For periods prior to December 31, 2010, the Schedule UB is a separate document under the Returns sub-tab. Starting with periods December 31, 2010 and forward, the Schedule UB is part of the actual return. In order to view the UB information, a user must select the return and then the Schedule UB tab located within the return. The information in the Schedule UB remains the same, only the location of the information has changed.

Display 2009 and prior:

Display 2010 and forward:

Click on the return doc type for that particular year to access the return.

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The return screen will open. The Schedule UB can then be viewed by clicking on the Schedule UB sub-tab on the far right.

2. Searching for Unitary Members

There are two options that a user can use to look up members of a Unitary Filing - the Unitary Search (sub-tab) or the Report Manager.

a) Unitary Search

The Unitary Search (sub-tab) can be accessed through the Financial Tab when in the taxpayer's account. This search is appropriate when the user is already on a **related** taxpayer account for which they have a business purpose and there is reason to believe that the taxpayer they are researching should be a part of the same group.

1) Click on the Unitary Search sub-tab to open the search.

2) The search box will appear. Enter the FEIN of the entity being searched for, then hit "Enter".

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3) If the FEIN is found, the information bar will appear below the search box. Click on the Filing Period.

4) The Schedule UB information of the entity that was searched for will be displayed.

b) Report Manager

The Report Manager should be used when determining if a taxpayer filed as a part of a unitary group for whom the designated agent is **unknown**, and the user does not have an audit assignment on a related taxpayer that could be in the same unitary group.

1) Access the Report Manager.

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2) Once in the Report Manager, click on the Report List tab.

3) The user can then quickly locate the ad hoc report by typing ***FEIN in Multiple Groups*** into the filter line, then hit “Enter”.

4) Click on the report title – FEIN in Multiple Groups.

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5) After selecting the report, the details screen will open allowing for the FEIN that the user is researching to be entered.

6) The results for this report look similar to the screen in the Unitary Search above.

7) Clicking on the Filing Period will bring up the Schedule UB information for the entity. This is the same screen as seen in the Unitary Search above.

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B. EXHIBIT B - HOW TO CHECK FOR OPEN WORK ITEMS

When in the taxpayer's account (BIT), click on the Task tab, then click on the Work Items sub-tab to see open work items pertaining to the taxpayer. The number of work items present (7 in this screen print) will be shown on the sub-tab.

The open work items details will be shown under the Work Items sub-tab. "Work Type" will need to be reviewed to determine if that particular work item should be addressed in the audit.

The following chart shows the work items that do **not** need to be addressed (all others will need to be "worked" as part of the audit).

Work Items that do not need Addressed
Amended Return Received
Original Return Received
TRM Send to Files
Audit Sent to Files
2nd Level Review….
Quality Review

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C. EXHIBIT C - HOW TO LOCATE PAYMENT INFORMATION IN GENTAX AND LEGACY PDF DISPLAY

1. Locating Payment Information in GenTax

To locate the payment information in GenTax, the auditor will need to be in the taxpayer's account, then click on the Payments sub-tab under the Financial Tab.

[redacted]

2. Accessing Payment Information in Legacy PDF Display

To access the payment detail in Legacy PDF Display the auditor will need to open Legacy PDF Display and follow the instructions in that program. See details on accessing Legacy PDF Display in AM Chapter 46.

BIT System Code Reference Card (EDA-78) – Payment/Credit History Codes

When reviewing taxpayer payment information in Legacy PDF Display, an understanding of history codes is necessary for determining payment types. The following payment history codes and their meaning are relevant to Audit:

Number	Type
2	System offset between IT & RT
3	Miscellaneous payment
4	Payment with return
5	ES payment
6	505 payment
7	Bill payment (BTR-85)
8	TPN payment (BTR-76)
9	Audit payment
17	ES credit forward payment
24	Chicago audit payment/ ATAT audit payment
25	Springfield audit payment

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3. Compare the GenTax information with the Legacy PDF Display data

a) GenTax

The transactions screen from GenTax is being used in this dollar comparison. The three marked Cnv Credits will be compared to the information available through Legacy PDF Display.

[redacted]

b) Legacy PDF Display

Payment information in Legacy PDF Display provides not only the payment amount(s) but also the Batch Doc Number, Payment Received Date, and Post Date. Payments will indicate the IT payment amount, RT payment amount and the total payment amount. When comparing payment amounts, the total payment amount in Legacy PDF Display should be matched to the amount as indicated on the GenTax screen. In this case, the Cnv Credit amounts are $786,000, $785,000 and $785,500 as presented below.

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BIT Payment - Seq 1

IT Batch Document Number	2004-289-351-01-079
IT Payment Status	ALLOWED AND APPLIED
IT Payment Received Date	10/15/2004
IT Payment Amount	$516,821.92
RT Batch Document Number	2004-289-351-01-079
RT Payment Status	ALLOWED AND APPLIED
RT Payment Received Date	10/15/2004
RT Payment Amount	$269,178.08
Post Date	10/22/2004
Protest Indicator	No
Total Payment Amount	$786,000.00 ←
Bad Check Code Description	
Adjustment ID	
Segment Number	1
Transfer Direction	
Transfer FEIN	
Transfer Sequence Number	
Transfer APE	0/

BIT Payment - Seq 2

IT Batch Document Number	2004-350-351-01-402
IT Payment Status	ALLOWED AND APPLIED
IT Payment Received Date	12/15/2004
IT Payment Amount	$516,164.38
RT Batch Document Number	2004-350-351-01-402
RT Payment Status	ALLOWED AND APPLIED
RT Payment Received Date	12/15/2004
RT Payment Amount	$268,835.62
Post Date	12/17/2004
Protest Indicator	No
Total Payment Amount	$785,000.00 ←
Bad Check Code Description	
Adjustment ID	
Segment Number	1
Transfer Direction	
Transfer FEIN	
Transfer Sequence Number	
Transfer APE	0/

BIT Payment - Seq 3

IT Batch Document Number	2005-074-351-01-206
IT Payment Status	ALLOWED AND APPLIED
IT Payment Received Date	03/15/2005
IT Payment Amount	$516,493.15
RT Batch Document Number	2005-074-351-01-206
RT Payment Status	ALLOWED AND APPLIED
RT Payment Received Date	03/15/2005
RT Payment Amount	$269,006.85
Post Date	03/18/2005
Protest Indicator	No
Total Payment Amount	$785,500.00 ←
Bad Check Code Description	
Adjustment ID	
Segment Number	1

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D. EXHIBIT D - HOW TO DETERMINE COLUMN A FIGURES

Correctly Identifying Column A Figures in GenTax

Financial information required for Column A (As Filed on the EDA-25) can be accessed through the Account View or the Audit View. The methods identified for obtaining the needed information take into account all users. This includes auditors who are assigned audits, auditors who are not assigned audits, management, legal services and others who may need to inquire on this type of information.

Taxpayer records can be located using the Search Manager found in the New Manager screen.

You can use the Search Manager to search for a customer using any information that has been recorded, such as name, address, identification number (FEIN or SSN) and more. Enter the search criteria in the green search line then hit Enter.

The Search Details screen opens. Click on the taxpayer's name.

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The Customer View opens providing information on the accounts set up for that particular taxpayer. To open the taxpayer's BIT account, click on the Account number hyperlink.

[redacted]

a) Account View

The Account View opens providing access to the financial information (returns, payments, etc.). The return information is accessed to determine Column A figures.

[redacted]

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Click on the Returns sub-tab under the Financial Tab, then click on the year specific return under *Doc Type*. The Return Detail screen will open.

Below is the 2008 IL-1120 return for this taxpayer. These are the figures that will typically be used for Column A, As Filed, of the EDA-25. If this screen indicates that there are multiple versions of this return, the auditor needs to use the most current version of the return (i.e. the highest number – for example 8 of 8 below).

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To view the side by side line changes for each version of the return, use the double arrow icon at the top of the screen.

Note: The auditor needs to be aware of the status of each filing period financial data. The financial data may be converted information from IRIS (now Legacy PDF Display) and there may be no additional adjustments in GenTax. The financial data may be converted information from IRIS with additional adjustments that were completed in GenTax. The financial data may only be GenTax with no converted data. If there is financial data that was converted to GenTax, the auditor will have to review Legacy PDF Display to correctly complete the EDA-25.

b) Audit View

Financial information can also be accessed through the Audit View. While in the Customer View, click on the Audit Tab to access the audits set up on the taxpayer, then click on the appropriate Audit track number to open the audit information details screen (Audit View).

This is the Audit View screen. Click on the appropriate return period.

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The Period View will open showing the Transactions. Click on the return blue hyperlink (in this case the IL-1120) which will open the return.

If this screen indicates that there are multiple versions of this return, the auditor needs to use the most current version of the return (i.e. the highest number – for example 8 of 8 below).

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[redacted]

c) Verification for EDA-25 Completion

The auditor needs to verify the following items prior to completing the EDA-25:

- Verify that the audit periods listed are correct.
- Verify that the filing periods included are correct for the audit period so that the auditor has the correct financials for the audit.
    - If the audit or filing periods listed are not correct it will be necessary for the auditor to contact the auditor's supervisor to make sure that the necessary corrections are made.
- Check the audit description, the CRM comments and the Electronic Documents to see Amended Returns that may be attached to the audit. If amended returns are referenced in the audit description or CRM comments, or they are attached in Electronic Documents, then these must be addressed in the audit.

Once the audit and filing periods are correct and amended returns have been taken into consideration, the EDA-25 can be prepared for that tax year.

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d) Identifying the Status of the Financial Data for Each Filing Period

(1) Financial Data that Has Converted Information from IRIS and Has No Additional Adjustments in Gentax

On the return detail screen shown below, the auditor will see cnvr1 and the date 04-Dec-2007.

Under the Transactions Tab, all of the transactions will have a Posted date of 04-Dec-2007 and a Trans Type beginning with Cnv.

In the above scenario, to obtain the correct figures for the EDA-25, Column A As Filed, the auditor will have to reference information in BOTH Gentax and Legacy PDF Display.

(2) Financial Data That Has Converted Information From IRIS And Has Additional Adjustments In Gentax

On the return detail screen shown below, the auditor will see an adjuster name and the date of the final adjustment for the return.

On the return detail screen show below, the auditor will see that more than one return version (4 of 4) exists which indicates adjustments have been made to the return since it was put into GenTax.

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Under the Transactions Tab, the transactions will have a Posted date of 04-Dec-2007 and other Posted dates following that date, and a Trans Type beginning with Conv and other Trans Types which indicates that the account has converted information and additional adjustments in GenTax since the conversion.

In the above scenario, to obtain the correct figures for the EDA-25, Column A, As Filed, the auditor will have to reference information in BOTH GenTax and Legacy PDF Display.

(3) Financial Data That Is Only In Gentax With No Converted Data From IRIS

On the return detail screen, the auditor will see one of the following:

Under the Transactions Tab, the transactions will have Posted dates after 04-Dec-2007 indicating that there was no data converted from IRIS.

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[redacted]

In the above scenario, to obtain the correct figures for the EDA-25, Column A, As Filed, the auditor will only have to reference information in GenTax.

(4) GenTax - Step 8 of the Tax Return (Lines 53-60 for an IL-1120)

The EDA-25 needs to accurately reflect all of the payments, credit carryforwards and refunds for a particular tax year. The taxpayer has a right to see the application of all of these items for each tax year.

In the Step 8 screen print shown below, the IL-1120 Lines 53-60 of this portion of the tax return in GenTax are lines that come directly from the tax return prepared by the taxpayer.

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[redacted]

Note: It is important that the auditor uses the detail under the Transactions sub-tab (example below), and other detail in GenTax (and/or Legacy PDF Display) to complete the EDA-25, Column A, As Filed and not rely upon the detail as shown in Step 8.

[redacted]

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E. EXHIBIT E - HOW TO CREATE THE EDA-135

While in the Audit View of the audit needing the initiation letter sent, click on the CRM Tab, then the Letters sub-tab. To generate the letter, click on the “Add” tab.

Double click EDA-135 Audit Initiation and complete the initiation letter.

The EDA-135 allows four options for situations in which this letter can be used and addressed.

1. Follow up to a phone call to the taxpayer advising they are under audit with a field appointment confirmation.
2. Follow up to a phone call to the taxpayer advising they are under audit with no appointment. (Typically for in-house staff but can be used by field auditors if no appointment time is set)
3. As a letter to the taxpayer without previous phone contact to advise them they are under audit.
4. As a letter to the taxpayer without a successful previous phone contact to advise them they are under audit with an appointment time.

Users will note that there are 3 check boxes initially available besides the initiation date:

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The initiation date is required to be entered, which will be the current day's date.

"Phone Contact" is to be used if making phone contact with the taxpayer.

The "Serves to Notify You That Effective" option is used when just making contact with the taxpayer by letter with no previous or no successful previous phone contact has been made.

The "Field Appointment" box is used whenever a field appointment is being made and is available with initially chosen box.

Once one of the first two choices ("Phone Contact" or "Serves to Notify You") on the left are made, the in-house RAR/non-filer choices are made available to the user.

Examples of box choices:

1. Phone Call/ Set Field Appointment:

2. Phone Call only no appointment:

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[redacted]

3. Letter only no phone call.

[redacted]

4. Letter no phone call but with Field Appointment

[redacted]

The rest of the input screen as shown below contains a list of items that the auditor may potentially need for the audit. Boxes need to be checked for each item to be requested. A free-form area is included that allows the auditor to ask for items not listed.

Note: It is recommended to only request those items which the Department does not already have access to. Do not check all of the boxes. Ask for only relevant items.

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[redacted]

After all boxes have been checked for the requested documentation, it is recommended to click on the Preview Letter tab in order to review the initiation letter before saving and printing. The preview letter will have "Preview" superimposed over the letter text. Do not print or send this version to the taxpayer.

[redacted]

Once completed and reviewed for accuracy, close the preview letter. You will be returned to the letter completion screen. Click on "Save" in the lower right-hand corner. The letter must be saved before it can be printed.

[redacted]

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The Audit View will reappear showing the Initiation Letter saved in the Audit Folder Letters, as shown below. The letter is now ready to be printed. Click on the "Audit Initiation" under *Letter Type* to open the letter.

[redacted]

After the letter is opened, move the cursor to the bottom part of the letter page till the function toolbar appears. Click on the "Printer" icon in the bar. The Print box will then come up allowing the letter to be printed.

Two copies of this initiation letter will need to be printed - one copy for the audit file and a copy that will be sent to the taxpayer.

REMEMBER: ONCE THE LETTER IS SAVED, IT IS ALWAYS IN GENTAX. If you save the letter and discover it is incorrect, you must invalidate the letter.

Invalidating a Letter

To invalidate a letter, open the initiation letter that was just created, by clicking on the letter ID hyperlink under "Letter ID".

[redacted]

The Letter Detail screen will open in Mail. Click on the Invalidate Tab.

[redacted]

The Comment box will open for input of the reason as to why the letter is being invalidated. After a comment is added, click the "OK".

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The Letter Detail will now show that the letter is invalid, and a note will show the reason for the invalidation.

Note: Once a letter has been invalidated, it no longer appears under the Letters subtab as it goes into “History”. To view an invalidated letter, click on the Show History Tab. Invalidated letters will appear grayed-out.

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F. EXHIBIT F – HOW TO GENERATE AN UPDATED STATEMENT OF CUSTOMER

To generate a Statement of Customer in GenTax, the Customer View must be opened. This Customer View will show all tax types that the taxpayer is registered for with the Department.

Updating Penalties & Interest for each account (and tax type) is necessary to determine an accurate balance due on any given taxpayer's account. Auditors are encouraged to update penalties & interest as a first step prior to issuing a customer statement or communication of a liability to the taxpayer to confirm that the information being provided to the taxpayer is the most current.

1. Step 1 - Updating Penalties & Interest

(for all accounts with a liability/credit balance).

- View and make note of the balance(s) due. The balance appears under the Periods sub-tab in the Financial Tab.

- Click the Update P&I action tab found at the top right of the screen. This action will instantly update the P&I and balances.

- The Update P&I box will open. Click on the Update Tab.

- The updated balance(s) will show in both the Financial Summary and the *After* line. The *Before* line shows the figures before the update.

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- Note that this process must be **repeated for each separate tax type**. Once all tax types have been updated, the Statement of Customer may be generated.

2. Step 2 - Generating the Statement of Customer

- While in the Customer View, click on the CRM Tab, then click on the Statements sub-tab. Click the View Statement on the right.

- The statement details information will appear. Click the Issue tab.

- The “Statement has been issued” box will appear. Click *OK*.

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- Click on the Letters sub-tab. The Statement of Customer just generated should appear at the top of the letters listing. Click on the Letter ID number.

- The Mail Letter Detail screen opens. Click on the View Letter tab. The actual statement will open so that the information can be reviewed before printing. After confirming the information, close the statement.

- Click on the Print tab.

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- The box opens asking if you want to print this item. Click Yes to print. The Adobe Reader screen should open showing the Statement of Customer.

[redacted]

- Move the cursor to the bottom part of the statement till the function toolbar appears. Click on the “Printer” icon in the bar. The Print box will then come up allowing the letter to be printed. Two copies should be printed, one for the taxpayer and one for the audit file.

- Once the statement has been printed, the Mail Letter Detail screen will change showing new tabs – *Reprint* and *Resend*. The screen shows that the statement was printed, and also provides the date and time that it was created and printed.

[redacted]

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The following is an example of how the GenTax generated Statement of Customer should look. Statement portion will appear above the bottom voucher portion. Voucher portion must be remitted with the payment.

Taxpayer Statement

STATE OF Illinois DEPARTMENT OF REVENUE tax.illinois.gov

April 13, 2010

Letter ID:

Taxpayer ID:
Total amount due: $13,169.87

HOUSTON TX 77210-

This statement lists our most recent information about your unpaid balance, available credits, or returns you have not filed. A payment voucher is included so you may pay the balance due.

IL Business Income Tax — Account ID:

Period	Tax	Penalty	Interest	Other	Payments/Credits	Balance
31-Dec-2007	10,748.00	1,712.20	709.67	-	-	13,169.87

Voucher portion on bottom of this statement must be remitted with the payment to the address on the voucher

Retain this portion for your records.
Fold and detach or perforation. Return bottom portion with your payment.

Taxpayer Statement (R-12/08) (136)

Letter ID:

Total amount due: $13,169.87
Write the amount you are paying below.

$_____
Write your Taxpayer ID on your check.

Mail this voucher and your payment to:
ILLINOIS DEPARTMENT OF REVENUE
PO BOX 19035
SPRINGFIELD IL 62794-9035

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G. EXHIBIT G – EDA-154 AUDIT EMAIL AUTHORIZATION

Illinois Department of Revenue

EDA-154 Audit Email Authorization

As part of our auditing procedures, prior to sending confidential information through Internet email, we must obtain your authorization.

Step 1: Your information

Account ID: _____

Taxpayer name: _____

Step 2: Authorization and password set up

If you would like to receive audit reports or other files regarding your business through Internet email, please indicate your preference.

☐ I do not authorize delivery of reports or files through Internet email.

☐ I authorize delivery of reports or files through Internet email.

Email address: _____

For additional security, the files can be password protected. If you would like the files to be password protected, please indicate the password to be used. _____

Step 3: Authorized representative

Name: _____

Title: _____

Date: _____

Step 4: Return instructions

Please complete and return to your auditor. We recommend that you email the completed form as an attachment to your auditor. If it is returned electronically, type in the required information.

Disclosure of this information is voluntary.

EDA-154 (N-06/12)

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H. EXHIBIT H – HOW TO ENTER POA INFORMATION IN GENTAX

This information was removed with the implementation of new Department POA procedure starting January 1, 2018. See AMU IT18-02 – to be incorporated into Audit Manual Chapter 2.

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I. EXHIBIT I – HOW TO SCAN AND ATTACH A DOCUMENT TO AN AUDIT IN GENTAX

1. Scanning a Document

Using an applicable copier, the document should be scanned to yourself via e-mail. The scanned document should be opened from your e-mail and saved, using the "save a copy" option, to your "H drive". For locations without scanners, please forward a copy to Audit Planning to have scanned as an attachment onto the audit.

The following format should be used when naming the document to save:
Taxpayer name, taxpayer ID, tax year, form number
(I.e. John Doe, 123-45-6789, 2005, IL-1040X)

Once the return has been saved to the "H drive", it will need to be attached to the GenTax audit. Note: Once the return has been successfully attached to the audit in GenTax, the e-mail containing the scanned return and the file on the "H" drive where the return was saved should be deleted.

2. Attaching a Document in GenTax

Step 1: Go into the Audit View

Step 2: Click on the CRM Tab, then on the Electronic Documents sub-tab. Click on the Add next to the "Auditor Attachment" in the "Section O: Planning" section.

Step 3: The Attachment entry screen will open. Fill in the applicable information:
Type: Auditor Attachment
File Name: Using the "browse" option, find the saved scanned document
Short Desc: enter the tax year and description (i.e. 2004 original 1040)

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When the Browse button above is clicked, the box below appears allowing for either a file name (if know) to be entered or for Browsing for the correct document.

After the correct file has been entered or selected, click on the Save.

The file name will now be populated. Add a description in the Short Description box. Save the attachment by clicking the Save tab.

Version 10 – the saved attachment will show under the Electronic Documents sub-tab.

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J. EXHIBIT J – FORM 8796-A, REQUEST FOR RETURN/INFORMATION

Request for Return / Information

(Federal/State Tax Exchange Program - State and Local Government Use Only)

SECTION A

Return to

Internal Revenue Service
Disclosure Scanning Operation
Stop 93A
Post Office Box 621506
Atlanta, GA 30362-3006

I am requesting the following identified return(s) / return information under terms of the Federal / State Tax Coordination Agreement. I understand disclosure or use of the information received for other than authorized tax administration purposes is subject to criminal and civil liabilities under sections 7213 and 7431 of the Internal Revenue Code.

SECTION B

1. Name of Taxpayer | SSN / EIN

Address

2. Information requested | Tax periods | Type of return/form

Copy of return(s) ☐ Yes ☐ No

Check the appropriate block:

☐ Transcript

☐ Audit Workpapers

☐ Outstanding balance of assessments including penalties and interest computed to _____

☐ Other (Specify below) (Date)

3. Reason requested (Check the appropriate block)

☐ Pending Examination ☐ Criminal Investigation

☐ Pending Collection Activity ☐ Other (Specify)

SECTION C

1. Name of employee making request | Date request made

2. Group Manager Signature | Group Manager phone number | Division / Branch / Group

3. Form Signature / Authorized Representative | Date signed | Telephone number

4. Requesting Agency

Agency name
Illinois Department of Revenue

Attention
Alison Wood

Street address
101 West Jefferson Street, MC 1-214

Street address

City, State, ZIP code
Springfield, IL 62702

Instructions for Form 8796-A, Request for Returns/Information under Federal/State Exchange Agreement

The form may be used by state and local tax agency personnel requesting return(s) or return information from IRS.

Complete Sections A, B and C. After signature approval, forward to the pre-printed address in Section A. State the agency's need and use for the requested data as specifically as possible in section B-3. A general statement that it is needed for tax administration is insufficient.

Note: Do not send expedite requests or other requests that require local handling to the address in Section A. Contact your local Disclosure Office. If the office agrees to expedite or otherwise handle your request locally, you will submit it directly to that office.

Form 8796-A (5-2011) Catalog Number 56568 www.irs.gov Department of the Treasury-Internal Revenue Service

K. EXHIBIT K – HOW TO CREATE THE AUDIT COMPLETION LETTERS – EDA-143-XX

Since creating completion letters in GenTax is similar to creating initiation letters, please refer to the instructions in Exhibit E for any additional screen steps that may be useful when generating these letters.

The following exhibit information applies when creating the six completion letters. Each of these letters would be accessed through the "Add" tab (see below), completed, reviewed, and then saved.

In the Audit View, click on the CRM Tab, then click on the Letters sub-tab. Click on the Add tab.

Select the appropriate completion letter from the list by clicking on the letter type (in this case the EDA-143-CA). The EDA-143IAPT should only be used for audits completed in APT.

The EDA-143CA allows for an audit that contains both original and amended returns. Since this letter will summarize the results of multiple years in many instances, it is important to have the details about each year readily available when generating the letter.

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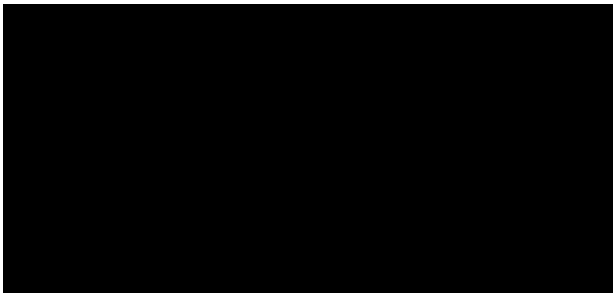
NOTE: It is important that this letter (EDA-143CA) NOT be issued until the audit findings are finalized. The issuance of this “results” letter or any of the other “results” letters set indicators and transactions which can impact the taxpayer’s account balances.

The Input Letter screen will appear which allows the auditor to input specific taxpayer information for the letter, and then preview that completed letter (click on the Preview Letter tab) for verification before saving the letter and then sending it to the taxpayer.

This is the screen (upper portion) that will be seen when the letter is opened. If the audit covers only one tax year, the “return” box should be selected (which is the default). If there are multiple years in the audit, then the “returns” box should be selected instead.

If the taxpayer has Illinois Net Loss Deduction (ILNLD) that they could have utilized but did not, then the ILNLD box should be selected.



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Based on the result of the audit, the “deficiency” or “overpayment” sections will be completed for each tax year.

Deficiency –

For the first year with a deficiency, select the deficiency box. Once the “deficiency” box is selected for the first tax year, a second box “additional deficiency?” will appear.

[redacted]

Deficiency information may be input for up to four tax years. In the event that more than four years within the audit resulted in a deficiency, a second EDA143CA will need to be completed.

[redacted]

Select “original” or “amended” for each year with a deficiency and complete the remaining boxes.

Overpayment –

For the first year with an overpayment, select the “overpayment” box. Once the “overpayment” box is selected for the first tax year, a second box “additional

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overpayment?" will appear. As with the deficiency information, overpayment information for four years can be completed.

Select "original" or "amended" for each year with an overpayment and complete the remaining boxes.

If one of the overpayments is out of statute, mark the checkbox "ONE overpayment". If more than one of the overpayments is out of statute, mark the "TWO OR MORE" box.

Completion Date –

The "completion date" is a required entry, which is entered in the lower portion of the Input Letter screen.

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Enter the completion date

When completed, *preview* your letter to ensure that the information in the letter fully details the results of the returns filed in audit.

Once the letter is completed and reviewed, click on the “Save” button at the bottom of the Input Letter screen.

The Audit View will reappear showing the Results Letter saved in the Audit Folder Letters, as shown below. The letter is now ready to be printed. Click on the “Results-Return Approval” under *Letter Type* to open the letter.

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After the letter is opened, move the cursor to the bottom part of the letter page until the function toolbar appears. Click on the "Printer" icon in the bar. The Print box will then come up allowing the letter to be printed.

Previewing IIT letters –

NOTE: There continues to be an issue with previewing IIT letters if you have secondary info, whereby the primary taxpayer's name is dropped from the address.

To ensure that BOTH taxpayers' names appear on correspondence, use the "change address" hyperlink to manually add both taxpayers' name and address information.

Specific instructions for the EDA-143-LR

If an EDA-143-LR is being generated, there is a separate box marked "Pre2002" which the auditor will check if the audit period includes any tax year ending prior to December 31, 2002. If the box is checked, GenTax will insert the following line on the EDA-143-LR:

> "This letter constitutes proper notification of the proposed decrease as required by the Illinois Income Tax Act, § 905(n)."

This line is not needed if the audit period includes a tax year ending after December 31, 2002 because IITA § 905(n) has no application after that date.

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Specific instructions for the EDA-143-NC

For clarity purposes some changes have been made to the EDA-143-NC letter. In the past the verbiage may have been misleading some taxpayers to believe that they may not owe money when in fact they did. Although the Department is accepting the return filed, the taxpayer is not recalling that they had a balance due which was not paid.

Because the audit was not establishing a liability or making changes to a return as filed during the audit, taxpayers have misinterpreted that as no money owed.

There are two options that can be chosen when using the EDA-143-NC – 1) No Liability or 2) No Change.

[redacted]

Either choice that is made will now contain the following verbiage:

> **Note: The review and acceptance of the submitted return may not change the existing account balance due, if applicable.**

1) No Liability letter presents the following language:

> This letter is to notify you that your audit for the tax type and audit period shown above has been tentatively completed, as of February 25, 2016. At this time, no liability has been assessed. All audits are subject to a quality review process. If no changes are made, you will receive a Notice of Audit Closure. You will be notified if additional information is needed.
>
> Note: The review and acceptance of the submitted return may not change the existing account balance due, if applicable.
>
> If you have any questions, contact us using the information listed below.

2) The "No Change" Option will show the following verbiage change to clarify the taxpayer may still have a balance due if the return was filed unpaid.

> This letter is to notify you that your audit for the tax type and audit period shown above has been tentatively completed, as of February 25, 2016. At this time, no changes have been made to your account. All audits are subject to a quality review process. If no changes are made, you will receive a Notice of Audit Closure. You will be notified if additional information is needed. If your return was filed showing a balance due and full payment has not been made, we will issue a bill, which will include any applicable penalty and interest.
>
> Note: The review and acceptance of the submitted return may not change the existing account balance due, if applicable.

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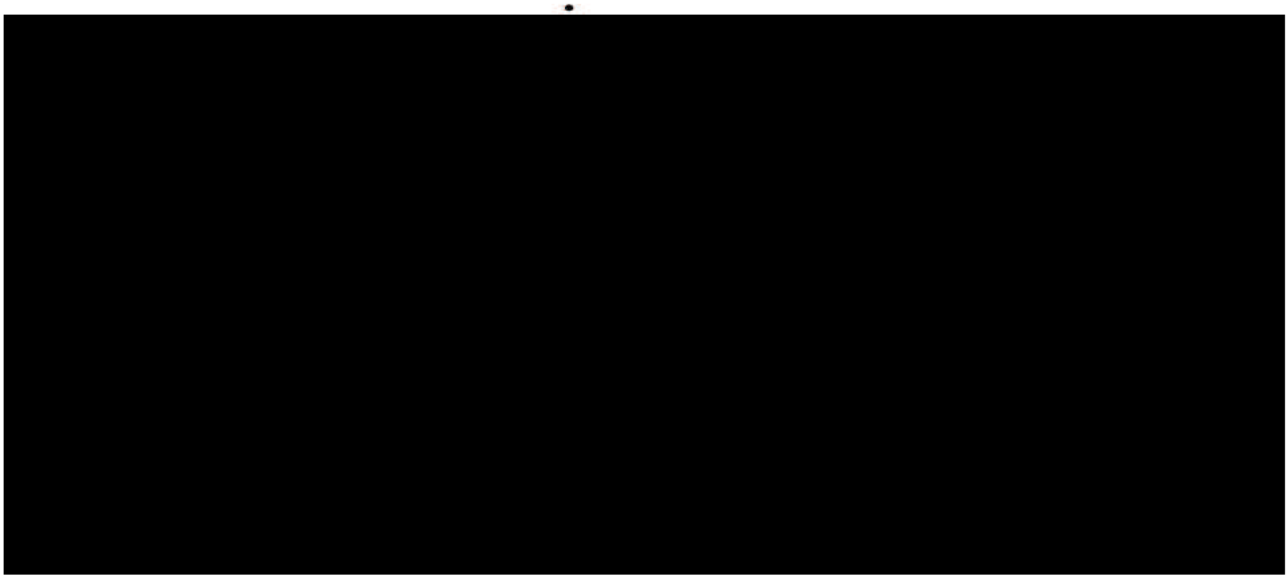
Specific instructions for the EDA-143-I-APT

For audits completed in APT, this new letter is still generated in Gentax from the Audit Springboard and has the same functionality. It has been modified to conform to the new procedures that have been put in place with the APT program, specifically the changes related to when a taxpayer can sign auditor's reports with the Jurat language to agree to an audit at the ICB rights level.

In addition to signing the Auditor's report(s) if they are in agreement, taxpayers are provided with offset information within the body of the letter should they agree to the entire audit period. This new verbiage is necessary since the IL-870 is no longer issued for an APT audit and the audit is not summarized in that process. Since the verbiage is slightly different, the entry screen is slightly different than the regular EDA-143-I.



The letter allows up to a four-year scope. As the user completes each year's information, another blank year will appear so that information can be input. If the entire audit period is a liability, this information is still entered for summary purposes for the taxpayer.

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L. EXHIBIT L – FORM EDA-8-A COLLECTION/LEGAL ACTION SUPPORT

Illinois Department of Revenue

EDA-8-A Collection/Legal Action Support Account ID: _____

On all unagreed or agreed without payment audits this form must be completed to support subsequent collection and/or legal action on nonpublicly traded corporations, partnerships, and sole proprietors.

1 List the names, residential addresses, Social Security numbers, and years of responsibility of all owners and officers who were responsible for filing and paying the taxes. Do not list those who were officers of convenience or investors only.

Name	Address	SSN	Years of responsibility
		- -	
		- -	
		- -	
		- -	

2 List the names and addresses of all business bank accounts and bank accounts of responsible officers.

3 If the business is discontinued, identify the residential address of the owner or responsible corporate officer on the tax return to ensure that they are properly notified of the liability.

4 List all known business assets, including property located in Illinois. This is particularly important with respect to firms located out-of-state.

5 List employees who could testify as to who the responsible officers were.

6 Identify if any business receipts were deposited into an account other than that of the business.

EDA-8-A front (R-8/10)
E-492-1979

7 Provide your recommendation as to who the responsible corporate officers are and on what information such recommendation was determined. **(Include any information in regard to responsible officer's ability to pay 100% Corporate Officer Penalty.)**

Name _____ Name _____

Basis for recommendation _____ Basis for recommendation _____

8 Attach copies of checks that paid the taxes and have been signed by the responsible officers and owners.

9 Attach copies of any corporate minutes available for the audit period.

10 Attach documentation that shows who authorized payments for items in lieu of taxes.

11 Additional information, if any.

I hereby recommend that after a determination has been made that if the corporation will not pay the liability established in the audit, we should issue an assessment for the 100% corporate officer penalty based upon the information contained herein.

Revenue auditor signature _____ Date _____

ECM-6-A back (R-6/70)

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M. EXHIBIT M – EDA-151 JEOPARDY ASSESSMENT ANALYSIS AND REQUEST

Illinois Department of Revenue

Jeopardy Assessment Analysis and Request

Complete this form and submit it immediately, with all attachments, to your Revenue Audit Supervisor (RAS) as soon as information and support is obtained or developed. The RAS will forward to the Assistant Division Manager for review.

Tax Type: Sales Tax [ ] IIT [ ] WIT [ ] BIT [ ] Other [ ]_____

Account ID:_____ FEIN: _____ SSN: _____

Taxpayer Name:_____ d/b/a (if different):_____

Address: _____ City, State, ZIP:_____

Contact Person:_____ Telephone:_____

Business Activity: Agricultural [ ] Construction [ ] Retail [ ] Services [ ]
Wholesale [ ] Manufacturing [ ] Reseller [ ] Solication [ ]

Describe business activities in Ilinois: _____

Amount of proposed jeopardy assessment

Description of tax	APE	Tax	Penalty	Interest	Total

Reason for request for jeopardy assessment: _____

Requested by:_____ **Title:**_____ **Date:**___/___/_____

Approved	Denied	Date	Signatures	
		___/___/_____		Immediate Supervisor
		___/___/_____		Asst. Div. Manager
		___/___/_____		Legal Services
		___/___/_____		Division Manager

Reasons for denial:_____

EDA-151 (R-06/10)

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N. EXHIBIT N – IDOR-8-J – NOTICE OF JEOPARDY ASSESSMENT

Notice of Jeopardy Assessment

for Form IL-1120-ST, Small Business Corporation Replacement Tax Return

STATE OF Illinois DEPARTMENT OF REVENUE tax.illinois.gov

January 24, 2014

Letter ID:

Account ID:
FEIN:
Reporting Period: December 2009

We have audited your Illinois Small Business Corporation Replacement Tax account for the reporting period listed above.

As a result we have assessed the amounts shown below.

Under 35 ILCS 5/1102 of the Illinois Income Tax Act the assessment of tax, penalty, and interest is **immediately payable** and **due** because the department has made a finding that our ability to collect taxes due from you may be jeopardized because you are about to depart from the state, or to conceal yourself or your property, or to do other acts that may prejudice or hinder any proceedings to collect such tax due from you. You must make **immediate** payment. See back page for payment information.

	Liability	Payments/Credit	Unpaid Balance
Additional Tax	25,795.00	0.00	25,795.00
Late-Payment Penalty	2,579.50	0.00	2,579.50
Late-Filing Penalty	250.00	0.00	250.00
Interest	2,548.44	0.00	2,548.44
Assessment Total	$31,172.94	$0.00	**$31,172.94**

If you do not pay the assessment or show us that the findings are in error **within five days** of this Notice of Jeopardy Assessment, the department may file a Jeopardy Assessment Lien and send you a notice explaining your rights to protest this lien. Provide a copy of this notice along with your payment or information to the department's auditor that your are working with or to the address below.

BUREAU OF AUDITS
TECHNICAL REVIEW SECTION
ILLINOIS DEPARTMENT OF REVENUE
PO BOX 19012
SPRINGFIELD IL 62794-9012

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O. EXHIBIT O - FORM EDA-4 REFERRAL TO INVESTIGATION

Use your mouse or Tab key to move through the fields. Use your mouse or space bar to enable check boxes.

Illinois Department of Revenue
Referral to Investigations

TO: Special Agent in Charge
Criminal Investigation Division

(All referrals must be forwarded to the Springfield office of CID, Mail Code W.I.B. 3-300)

Name & address of taxpayer:

DBA:

FEIN - SSN- Identification/IBT no:

Type(s) of tax(es) involved

Type _____

Period Covered _____

Person making referral

Name _____

Dist. # or _____ Phone _____

Office Loc.

Type of business

Estimated completion date of current assignment:

Estimated additional taxes due

Reason for referral: Finding - Observations - Taxpayer statements - etc. (attach additional sheets if necessary)

Signature of person making referral/date

Signature of supervisor/date

EDA-4 (R-10/14)

Manager signature

Signature of special agent supervisor

☐ Accepted
☐ Rejected

Reset Print

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P. EXHIBIT P - EDA-51 INCOME TAX AUDIT INDEX

1. EDA-51 Used by Field Auditors – Audits not in APT

INCOME TAX AUDIT INDEX

Taxpayer:
SNN/FEIN:

Track:
Status:

1. ☐ Statue Notice
2. ☐ Fed Tax Info
3. ☐ D. Agent Ltr
4. ☐ Prod-1
5. ☐ EDA-51
6. ☐ IL-872
7. ☐ EDA-122
8. ☐ EDA-125
9. ☐ IL-870 / EDA-143
10. ☐ Payment Voucher
11. ☐ Auditor Comments
12. ☐ EDC-5
13. ☐ IL-2848
14. ☐ EDA-27
15. ☐ ICB Folder (AD / Recom)
16. ☐ EDA-8-A (if applicable)
17. ☐
18. ☐

The following forms should be filed in date order:

Auditor's Report	19. ☐	23. ☐	27. ☐
Amended/Original Returns	20. ☐	24. ☐	28. ☐
Interest Schedule	21. ☐	25. ☐	29. ☐
Penalty Schedule	22. ☐	26. ☐	30. ☐

AUDIT SCEDULES

- ☐ Income Reconciliation
- ☐ Modifications
- ☐ US NOL Supporting Schedule
- ☐ Nonbusiness Income
- ☐ Partnership Income
- ☐ Property Everywhere
- ☐ Property Illinois
- ☐ Payroll Everywhere
- ☐ Payroll Illinois
- ☐ Sales / Single Factor Everywhere
- ☐ Sales / Single Factor Illinois
- ☐ IT Investment Tax Credit
- ☐ RT Investment Tax Credit
- ☐ Gross Receipts Test Sch.
- ☐ Investments Tax Credit Recapture
- ☐ IL Net Loss Deduction
- ☐ ILNLD Supporting Schedule
- ☐
- ☐
- ☐
- ☐

OTHER DOCUMENTS

☐ Correspondence	☐ Copy of IL Return	☐ Other:
☐ Initiation Letter	☐ Copy of US Return	☐ Other:
☐ Closing Letter	☐ Filing History	☐ Other:

EDA-51 (R-1/2009)

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2. EDA-51 Used by In-House Auditors – Audits not in APT

ILLINOIS DEPARTMENT OF REVENUE
INCOME TAX AUDIT INDEX-EDA-51

Taxpayer Name:
Audit Period:
FEIN/SSN:
Track#:
Statute:
Last Date Gentax Transcript Reviewed:

SECTION 1--AUDIT PROCESSING / LEGAL DOCUMENTS:

1.	☐	IL-872	11.	☐	IL-870	21.	☐	Schedule UB Audit
2.	☐	Statute Notice	12.	☐	EDA-153	22.	☐	AUB-2
3.	☐	Fed Tax Info-IRS Folder	13.	☐	Offset Authorization	23.	☐	SC-137 Referral
4.	☐	ICB Folder (AD Recom)	14.	☐	Payment Voucher Ck Rec'd	24.	☐	EDA-9 Audit Program
5.	☐	D. Agent Letter	15.	☐	EDA-135 Audit Initiation	25.	☐	EDA-27 Exp. Of Adj.
6.	☐	EDA-51 Audit Index	16.	☐	EDA-136 Audit Expansion	26.	☐	Gentax Trans. Panel
7.	☐	Prod-1	17.	☐	EDA-143 Audit Completion	27.	☐	
8.	☐	C17SUP	18.	☐	EDA-64 Auditor Comments	28.	☐	
9.	☐	EDA-122B	19.	☐	IL-2848 POA	29.	☐	
11.	☐	EDA-125	20.	☐	Email Authorization Form	30.	☐	

Year Ended:												
Auditor's Report	31.	☐	35.	☐	39.	☐	43.	☐	47.	☐	51.	☐
Amd/Orig Returns To Be	32.	☐	36.	☐	40.	☐	44.	☐	48.	☐	52.	☐
Gentax Generated Interest Schedule	33.	☐	37.	☐	41.	☐	45.	☐	49.	☐	53.	☐
Gentax Generated Penalty Schedule	34.	☐	38.	☐	42.	☐	46.	☐	50.	☐	54.	☐

SECTION 2--AUDIT SCHEDULES / WORK PAPERS:

☐	Schedule I Income Reconciliation	☐	EDC-5 Audit History
☐	Schedule II Modifications	☐	Correspondence
☐	Schedule II-C Federal Net Loss Subtraction	☐	EDA-70-Information Document Requests
☐	Schedule II-D Foreign Dividend J	☐	IDR-829 Great Lakes Questionnaire
☐	Schedule III Nonbusiness Income	☐	
☐	Schedule IV Partnership Income	☐	
☐	Schedule IX Sales Everywhere	☐	
☐	Schedule X Sales Illinois	☐	
☐	Schedule XI IT Investment Tax Credit	☐	
☐	Schedule XII RT Investment Tax Credit	☐	
☐	Schedule XII-B Gross Receipts Test Schedule	☐	
☐	Schedule XIII Investments Tax Credit Recapture	☐	
☐	Schedule XIV IL Net Loss Deduction	☐	
☐	Schedule XIV-A ILNLD Supporting Schedule	☐	
☐	Schedule XVII Unitary Business Income	☐	
☐	Schedule XVIII Combine As-Filed Calculation	☐	
☐	Schedule UB-INS (For Insurance Audits Only)	☐	

SECTION 3— OTHER DOCUMENTS / QUESTIONAIRES / EXHIBITS:

☐	Copy of IL Return	☐	IDR-829 Great Lakes Questionnaire	☐	
☐	Copy of US Return	☐	Nonbusiness Income Questionnaire	☐	
☐	IRIS History	☐		☐	
☐	CAF-Prior Audit Work Papers	☐		☐	
☐	CAA-Documentation	☐		☐	
☐	Amended Returns-Do Not Process	☐		☐	
☐	EDA-132 Unitary Questionnaire	☐		☐	
☐	Nexus Questionnaire	☐		☐	

EDA-51 (R/Prod-51 2/12)

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3. EDA-51 Used for Audits Completed in APT

EDA-51 Income Tax Audit Index

STATE OF Illinois DEPARTMENT OF REVENUE

Taxpayer:
Audit Period: 12/31/2013 through 12/31/2015
FEIN:

Audit ID:
Statute:
Last Date Gentax Transcript Reviewed:

Section 1: Audit Processing and Legal Documents

- ☐ Federal Tax Info
- ☐ IL-872 Consent to Extend Statute
- ☐ ICB folder (A/D Recom)
- ☒ EDA-51 Audit Index
- ☐ Prod-1
- ☐ IDR-229-UB Chg in DA
- ☐ IL-870 Waiver of Restrictions
- ☐ EDA-153 Accept Revised Claim
- ☐ EDA-64 Auditor Comments
- ☐ EDC-5 Audit History
- ☐ Payment Voucher
- ☐ Reasonable Cause Approval
- ☐ Neg/fraud Pen Approval
- ☐ Offset Authorization

Year Ended (Each set by year):	2013	2014	2015
*Auditor's Report	☐	☐	☐
Amended/Original Returns to be Processed	☐	☐	☐
*EDA-27 Explanation of Adjustments	☐	☐	☐
Schedule UB Inc Supplemental (New/Removed Group Members)	☐	☐	☐
*Audit Schedule UB	☐	☐	☐
Schedule UB-INS (if applicable)	☐	☐	☐
GT Interest	☐	☐	☐
GT Penalty	☐	☐	☐

Section 2: APT Audit Schedules & Auditor Prepared Work Papers (*APT Required Schedules for Audit Changes)

Income Reconciliation	☐	☐	☐
Income Reconciliation Supplemental	☐	☐	☐
*IL-4562 Bonus Depreciation	☐	☐	☐
Bonus Depreciation Supplemental	☐	☐	☐
*Schedule 80/20 Related Party Expenses	☐	☐	☐
Distributive Share Additions/Subtractions	☐	☐	☐
*Schedule M Other Additions/Subtractions	☐	☐	☐
Schedule 1299B Enterprise Zone/High Impact Business Sub Mods	☐	☐	☐
Schedule J Foreign Dividend Sub Mod	☐	☐	☐
Schedule NB Non-Business Income Deduction	☐	☐	☐
Non-unitary P/S/T/E Income/Loss Deduction	☐	☐	☐
Apportionment Factor Worksheet			
Sales Everywhere	☐	☐	☐
Sales Illinois	☐	☐	☐
Loss Reduction/Discharge of Indebtedness Worksheet	☐	☐	☐
Schedule NLD or UB/NLD	☐	☐	☐
ILNLD Supporting Schedule	☐	☐	☐
Schedule 4255 Investment Credit Recapture	☐	☐	☐
IL-477 Replacement Tax Investment Credits	☐	☐	☐
Gross Receipts Test Schedule	☐	☐	☐
*Schedule 1299D Income Tax Credits	☐	☐	☐

Section 3: Other Documents, Questionnaires, and Exhibits

- ☐ EDA-135 Audit Initiation
- ☐ EDA-136 Audit Expansion
- ☐ ICB Notice (EDA-122/124/125)
- ☐ EDA-143 Audit Completion
- ☐ IL-2848 Power of Attorney
- ☐ EDA-154 E-mail Authorization
- ☐ Other Taxpayer Correspondence
- ☐ EDA-70 Info Doc Requests
- ☐ EDA-130 IDR for ATAT
- ☐ EDA-132 Unitary Questionnaire
- ☐ Nexus Questionnaire
- ☐ Non-Business Questionnaire
- ☐ IDR-829 Great Lakes Questionnaire
- ☐ EDA-8-A Collection/Legal Action Support
- ☐ SC-137 Audit Referral
- ☐ Copy of IL Return
- ☐ Copy of US Return
- ☐ GenTax Trans Panel/IRIS History
- ☐ CAF Prior Audit Info
- ☐ CAA Documentation
- ☐ Amended Returns-DO NOT PROCESS

EDA-51 (R-03/13)

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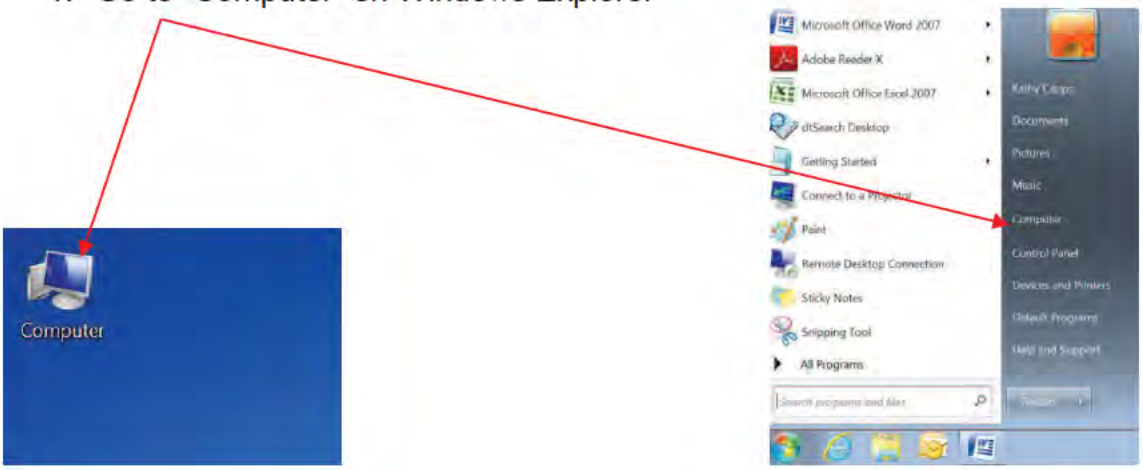
Q. EXHIBIT Q – HOW TO SAVE AUDITS TO THE NETWORK

1. Go to "Computer" on Windows Explorer



2. Paste or type the link (\\tiamat\sys\audits\users) into the address bar

[redacted]

3. Locate the auditor's last name

[redacted]

4. Double-click on the auditor's last name folder

[redacted]

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5. Right-click and select New, Folder

6. CAREFULLY type the audit Track number and name of taxpayer

7. Double-Click to open the new folder you just created

8. Next go to your computer where the audit and applicable files are stored.

For example:	ROT	c:\upload\audit.zip
	CIT	c:\cit audits
	IFTA	c:\cas\iftafile

Include all electronic documents that may be stored on C: and H: drives, and any other electronic documents pertaining to the audit.

9. HIGHLIGHT all applicable files, right click, and select COPY to hold the files in memory.

10. Then go back to the new storage folder you already created by track number and name, right-click and past the files into it. Your audit information is now in the network storage.

For faster access to folder information, the link \\tiamat\sys\audits\users may be saved to Favorites, or a Shortcut may be created on the computer desktop.

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R. EXHIBIT R – FORM FOR SUMMARIZATION OF TAXPAYER MEETINGS

Summarization of Auditor-Taxpayer Meeting Dated ___/___/___

A. Taxpayer name, Audit Track# and Which meeting was it? First, Second, etc.

1. _____
2. _____
3. _____

B. What was the purpose of the meeting?

_____
_____
_____
_____
_____

C. When did the meeting take place, was it a face to face meeting or telephone conference?

_____
_____

D. Who attended? Who did not? (if it matters)

1. _____
2. _____
3. _____
4. _____

E. What topics/issues were discussed?

1. _____
2. _____
3. _____
4. _____

F. What decisions were made?

1. _____
2. _____

1 | Page

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3. _____

4. _____

G. What actions were agreed upon? Who is to complete them? By when?

1. _____

2. _____

3. _____

4. _____

5. _____

H. Which topics were tabled for the future?

1. _____

2. _____

3. _____

4. _____

I. What materials were distributed? Where are copies available?

1. _____

2. _____

J. Is a follow-up meeting scheduled? When? Where? Why?

1. _____

2. _____

3. _____

K. Any other notes from the meeting that the auditor finds relevant:

_____

_____

_____

_____

L. Date summarization was mailed or emailed to taxpayer:

1. _____

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M. Additional Notes for items above:

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S. EXHIBIT S - FORM 3949-A, INFORMATION REFERRAL

Form **3949-A** (March 2014)

Department of the Treasury - Internal Revenue Service

Information Referral

(See instructions on reverse)

OMB Number 1545-1960

Use this form to report suspected tax law violations by a person or a business.

CAUTION: READ THE INSTRUCTIONS BEFORE COMPLETING THIS FORM. There may be other more appropriate forms specific to your complaint. (For example, if you suspect your identity was stolen, use Form 14039.)

Section A – Information About the Person or Business You Are Reporting

Complete 1, if you are reporting an individual. Complete 2, if you are reporting a business only. Complete 1 and 2 if you are reporting a business and its owner. *(Leave blank any lines you do not know.)*

1a. Name of individual	b. Social Security Number/TIN	c. Date of birth
d. Street address	e. City	f. State / g. ZIP code
h. Occupation	i. Email address	
j. Marital status *(check one, if known)* ☐ Married ☐ Single ☐ Head of Household ☐ Divorced ☐ Separated	k. Name of spouse	
2a. Name of business	b. Employer Tax ID number (EIN)	c. Telephone number
d. Street address	e. City	f. State / g. ZIP code
h. Email address	i. Website	

Section B – Describe the Alleged Violation of Income Tax Law

3. Alleged violation of income tax law. *(Check all that apply.)*

☐ False Exemption	☐ Unsubstantiated Income	☐ Unreported Income	☐ Failure to Withhold Tax
☐ False Deductions	☐ Earned Income Credit	☐ Narcotics Income	☐ Failure to File Return
☐ Multiple Filings	☐ Public/Political Corruption	☐ Kickback	☐ Failure to Pay Tax
☐ Organized Crime	☐ False/Altered Documents	☐ Wagering/Gambling	☐ Other *(describe in 5)*

4. Unreported income and tax years
Fill in Tax Years and dollar amounts, if known *(e.g., TY 2010- $10,000)*
TY ____ $ _____ TY ____ $ _____ TY ____ $ _____ TY ____ $ _____ TY ____ $ _____ TY ____ $ _____

5. Comments *(Briefly describe the facts of the alleged violation-Who/What/Where/When/How you learned about and obtained the information in this report. Attach another sheet, if needed.)*

6. Additional information. Answer these questions, if possible. Otherwise, leave blank.
a. Are book/records available? *(If available, do not send now. We will contact you, if they are needed for an investigation.)* ☐ Yes ☐ No
b. Do you consider the taxpayer dangerous? ☐ Yes ☐ No
c. Banks, Financial Institutions used by the taxpayer

Name			Name		
Street address			Street address		
City	State	ZIP code	City	State	ZIP code

Section C – Information About Yourself

(We never share this information with the person or business you are reporting.)
This information is not required to process your report, but would be helpful if we need to contact you for any additional information.

7a. Your name	b. Telephone number	c. Best time to call
d. Street address	e. City	f. State / g. ZIP code

Please print and send your completed form to: Internal Revenue Service
Stop 31313
Fresno, CA 93888

Catalog Number 47872E www.irs.gov Form **3949-A** (Rev. 3-2014)

DUE DATES, EXTENSIONS, & STATUTE CONTROL

Revised 5/2018

Reviewed 8/2019

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XV. FRAUD.....40

I. PURPOSE

This chapter describes the various due dates and extensions available and the statutes applicable to the original and subsequent returns.

II. DUE DATES

IITA § 505(a) contains the provisions for the due dates of original returns. The general statutory rule is that the postmark date establishes the legal filing date for an item of mail passing through the U.S. Postal Service. Ref: 5 ILCS 70/1.25.

INCOME TAXES

Tax or program	Form number	Filing Frequency	Due date
Individuals	IL-1040	Annually	On or before 15th day of 4th month following close of tax year
Individuals (estimated payments)	IL-1040-ES	Quarterly	April 15, June 15, September 15, January 15
Individuals (automatic extension payment)	IL-505-I	Annually	On or before due date of original return
Composite	IL-1023-C	Annually	15th day of 4th month following close of tax year. See note below
Composite (estimated payments)	IL-1023-CES	Quarterly	April 15, June 15, September 15, January 15 (will differ for fiscal year filers) – see note below.
Corporations	IL-1120	Annually	15th day of 4th month following close of tax year (for tax years beginning on or after January 1, 2016 and ending on a date other than June 30) 15th day of 3rd month following close of tax year (for tax years beginning on or after January 1, 2016 and ending on June 30)
Corporations (estimated payments)	IL-1120-ES	Quarterly	April 15, June 15, September 15, December 15 (will differ for fiscal year
Estates	IL-1041	Annually	15th day of 4th month following close of tax year
Exempt organizations	IL-990-T	Annually	15th day of 5th month following close of tax Year
Partnerships	IL-1065	Annually	15th day of 4th month following close of tax Year
S Corporations	IL-1120-ST	Annually	15th day of 3rd month following close of tax Year
Trusts	IL-1041	Annually	15th day of 4th month following close of tax Year

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Cooperatives	IL-1120	Annually	15th day of 9th month following close of tax Year
Businesses	IL-505-B	Annually	On or before due date of original return
Pass-through Entity Payment	IL-1000/IL-1000-P	Annually	See note below

Note: IL-1023-CES and IL-1000-P have been eliminated and cannot be used for making prepayments for tax years ending on or after December 31, 2014, and that the IL-1023-C and IL-1000 are retired for years ending on or after December 31, 2014. The payment vouchers (1023-CES and 1000-P) are replaced by Forms IL-516-I and IL-516-B for years ending on or after December 31, 2014.

Estimated payments & Returns Individuals and Corporations

Year ending	1st installment due	2nd installment due	3rd installment due	4th installment due	Ind. return due	Corp. return due
1/31	5/15	7/15	10/15	2/15 Ind. 1/15 Corp	4/15	5/15
2/28	6/15	8/15	11/15	3/15 Ind. 2/15 Corp	5/15	6/15
3/31	7/15	9/15	12/15	4/15 Ind. 3/15 Corp	6/15	7/15
4/30	8/15	10/15	1/15	5/15 Ind. 4/15 Corp	7/15	8/15
5/31	9/15	11/15	2/15	6/15 Ind. 5/15 Corp	8/15	9/15
6/30	10/15	12/15	3/15	7/15 Ind. 6/15 Corp	9/15	10/15
7/31	11/15	1/15	4/15	8/15 Ind. 7/15 Corp	10/15	11/15
8/31	12/15	2/15	5/15	9/15 Ind. 8/15 Corp	11/15	12/15
9/30	1/15	3/15	6/15	10/15 Ind. 9/15 Corp	12/15	1/15
10/31	2/15	4/15	7/15	11/15 Ind. 10/15 Corp	1/15	2/15
11/30	3/15	5/15	8/15	12/15 Ind. 11/15 Corp	2/15	3/15
12/31	4/15	6/15	9/15	1/15 Ind. 12/15 Corp	2/15	4/15

Employer's Withholding Income Tax

Tax or program	Form number	Filing frequency	Due date
For tax years on or after January 1, 2014:			
Withholding payment. (Purchasing the rights to future payments of Illinois lottery winnings)	IL-501	Pay by the 15th day of the month following the purchase with the IL-501.	

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Withholding tax (Purchasing the rights to future payments of Illinois lottery winnings)	IL-941	Due the last day of January following the year in which the rights are purchased.	
For tax years on or after January 1, 2008:			
Withholding payments	IL-501	Semi-weekly Monthly- 15th of month Annually- January 31 of the following year	>$12,000 – semi-weekly >$1,000 - $12,000 – monthly $1,000 or less – annually
Withholding tax	IL-941	Quarterly	April 30, July 31, October 31, and January 31 of the following year
	IL-941-A	As of January, 1· 2011 became obsolete, now filed on IL-941	January 31 of the following year
For tax years prior to January 1, 2008:			
Withholding payments	IL-501	based on accumulated amount of withholding	$1,000 or more – weekly $500 - $999 – monthly Less than $500 – annually
Withholding tax	IL-941	Quarterly	April 30, July 31, October 31, and January 31 of the following year
Note: If the accumulated amount withheld is less than $500 for the year, a taxpayer may file Form IL-941 and pay any accumulated amount of withholding on or before January 31 of the following year. Use Form IL-941 for the fourth quarter as your annual return.			
Annual reconciliation	IL-W-3	Annually	February 28 of year following Reporting period regardless of filing status

A. Exceptions

The IITA and departmental policy allow for several exceptions to the general due date.

1. Federal

If the return of a corporation is due (without regard to extensions) for federal purposes on a return with a due date later than the 15th day of the third month following the close of the taxable year, the same due date will apply to the corresponding Illinois return. Ref: IITA § 505(a)(1)

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2. **Partnerships and Fiduciaries**

Partnership and fiduciary returns are due on or before the 15th day of the fourth month following the close of the taxable year, unless extensions are granted. Ref: IITA § 505(a)(2)

S Corporations and personal service corporations are able to file their Illinois income tax returns in accordance with 26 CFR § 1.444.3T(c)(1)(i).

- They can take advantage of the automatic Illinois filing extensions in addition to the extended due date allowed by IRC § 444 election.
  - The automatic Illinois extension applies only to the filing of the return, not to paying the taxes. Ref: Informational Bulletin FY 89-7.

3. **Certain Exempt Organizations**

The returns of organizations exempt from federal taxation which determine base income under IITA § 205(a) are due by the 15th day of the fifth month following the close of the taxable year, unless extensions are granted. Ref: IITA § 505(a)(3)

4. **52/53 week filer**

A 52/53 week filer is a taxpayer that has elected under IRC § 441(f) to have a fiscal year that varies from 52 to 53 weeks. For filing purposes, the last day of the taxable year is deemed to be the last day of the calendar month ending nearest to the last day of the taxpayer's actual year.

Note: Taxpayers with short-year returns due to liquidations, mergers, IRC § 338 elections, etc., often reflect year-ends that are not at the end of a month. In these cases, the due date is calculated based on the 15th day of the third full month following the close of the tax year.

- This is not the same rule that applies to 52/53-week filers. If a taxpayer is being incorrectly billed for a late-filing penalty because of a short year return being treated by the Department as a 52/53 week filer, the taxpayer should use the contact information provided on the correspondence to request to have penalty removed.

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Example of fiscal filer reported on GenTax:

[redacted]

5. **Cooperatives**

   The annual return of a cooperative is required to be filed on or before the 15th day of the ninth month following the close of the cooperative's taxable year. For these purposes, a cooperative is any taxpayer that determines its federal taxable income in accordance with 26 USC §§ 1381 through 1388. Ref: IAC § 100.5000(a)(3) and IITA § 203(e)(2)(F)

6. **Saturday/Sunday/Holiday**

   If the due date for any return, other report or payment falls on Saturday, Sunday or a holiday, a return or report filed, or payment made, on the next business day is considered timely. Ref: IAC § 100.5000(b)

III. DEEMED ASSESSED (ADMITTED) LIABILITIES (NOTICE AND DEMAND)

A deemed assessed liability is one for which the taxpayer has no recourse before payment. We also refer to this type of liability as “admitted liability”, since the taxpayer has reported and “admitted” to owing this liability to the Department.

- The taxpayer has conceded that a liability exists based on:
  1. An original Illinois return reflecting tax due (along with any applicable interest or penalties).

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2. An amended return reflecting additional tax liability (along with any applicable interest or penalties), or
3. Any amount of tax liability understated on the return due to a mathematical error (along with any applicable interest or penalties).

For liabilities deemed assessed, the Department is required to only issue a Notice and Demand for payment.

- Any amount which has been timely issued is then protected against statute expiration.
- The taxpayer has no right of protest a Notice and Demand, as it does not constitute a Notice of Deficiency. Ref: IITA § 902(a) & 903(a) and IAC § 100.9200(a)(1)(A).

A Notice and Demand is the last notice sent to a taxpayer prior to the filing of a lien.

- If the taxpayer disagrees with the adjustment, their only recourse is to pay the Notice and Demand and file a claim for refund.
- The payment should be received within 30 days after the issuance.
  - If payment is not received the Department may then file a lien and/or initiate other seizure activities, as warranted. Ref: IITA §§ 1101 and 1109.

A. NOTICE AND DEMAND

1. In General

Any tax, which is shown on the face of an original return but not paid, and any applicable interest or penalties, becomes deemed assessed upon the filing of the return.

- The Department must issue a Notice and Demand for payment of the tax due.
  - The Department has 3 years from the date the original or amended return is filed to issue a Notice and Demand for payment of the liability due. Ref: IITA §§ 902(a) and 903(a)(1)
- An additional liability resulting from adjusting a taxpayer's return for a math error (as defined in IITA § 1501(a)(12)) is also considered deemed assessed on the date the return is filed.
  - For an in-depth explanation of mathematical errors (math errors), refer to Chapter 20 Income Tax Audit Procedure.

A deemed assessment is subject to the lien provisions as described in IITA § 1101. The statute of limitations on a liability resulting from tax shown on the original return or a math error cannot use form IL-872 to extend the statute date, based on being deemed assessed as opposed to being proposed. This three-year rule also applies to an amended return concerning the changes made on a return resulting in additional tax being due.

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2. **Math-error corrections (IITA § 1501(a)(12)**

The term “mathematical error” includes the following types of errors, omissions, or defects in a return filled by a taxpayer which prevents acceptance of the return filed by a taxpayer which prevents acceptance of the return as filed for processing:

(A) Arithmetic errors or incorrect computations on the return or supporting schedules;
(B) Entries on the wrong lines;
(C) Omission of required supporting forms or schedules or the omission of the information in or in part called for thereon; and
(D) An attempt to claim, exclude, deduct, or the provisions of the Act and regulations thereunder any item of income, exemption, deduction, or credit.

3. **Court Case**

In the case of the Department of Revenue v. William J. Walsh, 1990 the Circuit Court ruled that a subtraction modification not specifically provided for in the Act could NOT be construed by the Department to be a math error. Therefore, a Notice of Deficiency should have been issued allowing taxpayer the right to protest prior to payment of the additional liability. This ruling was made in August 1988 and the Department subsequently requested reconsideration by the Court. In March of 1990, the Appellate Court REVERSED the Circuit Court's Judgment. Therefore, the Department's policy remains: if a taxpayer claims an item of deduction not specifically provided for in the IITA, the questionable deduction will be disallowed, considered a math error and a Notice and Demand will be issued for the additional amount due.

4. **Amended returns**

Additional tax shown to be due on an amended return is deemed assessed on the date of filing of the return. A Notice and Demand shall be issued for any tax shown and not paid upon the filing of the amended return. The interest and demand on that amended return would need to be issued within 3 years of the amended filing, an extension cannot be obtained to extend the statute for a Notice and Demand.

If a taxpayer files a claim for refund, the Department has three years from the date the claim was filed to reduce the refund due to a math error discovered on the claim.

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IV. PROPOSED LIABILITY (NOTICE OF DEFICIENCY & PROPOSED NOTICE OF DEFICIENCY)

A. Notice of Deficiency-Original Return

Regarding an original return filing, a Notice of Deficiency shall be issued by the Department within 3 years of:

- The automatic extension date, OR
- The date the return was filed, using the later of the two dates.

The following chart summarizes the statutes of limitation:

ORIGINAL RETURN FILED	DEFICIENCIES	CLAIMS FOR REFUND
On or Before Extended Due Date	Statute of Limitations begins on Extended Due Date	Statute of Limitations begins on Extended Due Date, or one year after the tax was paid, whichever is later
After the Extended Due Date	Statute of Limitations begins on Date the Return was Filed	Statute of Limitations begins on Date the Return was Filed, or one year after the tax was paid, whichever is later

There are many exceptions to this rule- please see discussion within the Extension section below.

B. Mandatory Filing of Combined Returns

<u>Years ending on or after December 31, 1993</u>

Eligible members are required to file a combined return and be treated as one taxpayer for purpose of original and amended returns,

Each combined group is required to properly complete and file a combined return (using Form IL-1120 and Schedule UB) by the due date of the return (including extensions). For the first year for which a combined return must be filed, a single combined request for extension of time to file the return can be made by one member acting as designated agent on behalf of the entire combined group, even though the designated agent will not actually be appointed until the combined return is filed.

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If, on audit, the Department determines that two or more corporations are members of a unitary business group for which no combined return was filed, the following rules apply:

1. Any audit liabilities determined by the Department will be processed on a combined return basis. Because each member of a combined group is jointly and severally liable for the tax liability of the entire group, if any Notices of Deficiency are issued:

    a) The Notices of Deficiency shall reflect the combined return income and liability of the entire combined group; and

    b) A Combined Notice of Deficiency must be issued to each Illinois taxpayer, unless a designated agent has been appointed under IAC §100.5220(f), in which case the Department may issue a Notice of Deficiency solely to the designated agent and to any corporation which has requested the Department to be allowed to represent itself pursuant to IAC § 100.5220(f)(2).

If two or more corporations have filed a combined return and, on audit, the Department determines that one or more additional corporations belonged to the combined group and should have joined in the filing of the combined return, any audit liabilities shall be proposed and processed as follows:

1. If, prior to the issuance of a Notice of Deficiency, any of the corporations which did not join in the combined return and the designated agent of the combined group agree that such corporation is a member of the combined group or the designated agent pays all audit deficiencies the audit liabilities related to that corporation and the combined group will be proposed and processed on a combined return basis. In this instance, the Department treats the designated agent as having corrected the combined return in accordance with IAC § 100.5210(b).

2. If the designated agent of the combined group, or any corporation which did not join in the combined return, does not agree that such corporation is a member of the combined group prior to the issuance of a Notice of Deficiency, the audit liabilities for that corporation will nevertheless be proposed and processed on a combined return basis. Because each member of a combined group is jointly and severally liable for the tax liability of the entire group, if any Notices of Deficiency are issued:

    a) The Notices of Deficiency shall reflect the combined return income and liability of the entire combined group; and

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b) A Combined Notice of Deficiency will be issued to the designated agent and to each new eligible member corporation, which did not join in the filing of the combined return, but which the Department is asserting is an eligible member of the combined group. Each Notice of Deficiency shall state that the designated agent shall represent each corporation whose membership in the combined group is in dispute unless such corporation requests the Department to be allowed to represent itself pursuant to IAC § 100.5220(f)(2).

Note: If an amended return is audited and an additional liability above what was reflected on the amended return is proposed, a Notice of Deficiency shall be issued for the proposed liability in accordance with the provisions of IITA § 905. While an amended return does not extend the statute for issuing a Notice of Deficiency for issues reported on the original return, if the amended return reports an overpayment, the expiration of the limitations period for issuing an NOD does not prevent the Department from raising any issue that will reduce the amount of the overpayment.

Example

Corporation A filed Form IL-1120 for the calendar year 2006 on October 15, 2007. On the original return Corp. A claimed non-business income from CD's. On March 10, 2009, Corp A filed Form IL-1120X reporting additional liability due to the reporting of a previously unreported addition modification and the reclassifying of interest income received from trade receivables as nonbusiness income.

An audit was completed on the 2006 year in December 2010. The interest from CD's and trade receivables was determined to be business income. The period for issuing a Notice of Deficiency due to the disallowance of the CD interest as nonbusiness income, (the original return) expires October 15, 2010. The period for issuing a Notice of Deficiency due to the disallowance of the trade receivable interest as non-business income expires March 10, 2012.

An extension of the period for issuing a Notice of Deficiency is allowed under IITA § 905(f) if, prior to the expiration of the time period allowed under IITA § 905, both the Department and the taxpayer consent, in writing, to extend the time period.

C. Amended Return not treated as original

The Department's position is amended returns (where no original filed) do not constitute the equivalent of "original" returns. Therefore, no statute is involved on any proposed liability resulting from the amounts shown in Column A ("As originally

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reported") of the Illinois return. Ref: Rockwood Holding Company v. Department of Revenue, 2000

- The auditor should advise the taxpayer that the Department has no proof of an original return filed and allow the taxpayer a chance to supply proof of filing.
  - "Proof of filing" in this instance, would be a copy of the original signed Illinois return dated by the Department, or
  - Cancelled check for any amount of tax paid with the original return.
    - If the taxpayer cannot supply proof of filing of the original return, a liability shall be proposed to the taxpayer using the best information available.
- This information is based on the amounts shown on the amended return.

Example

Corporation A files an amended return for calendar year 2006 on June 30, 2008. The amended return is filed as a result of a federal RAR, which increased federal taxable income (and Illinois Line 1) from $400,000 to $500,000. The Department has no record of an original return filed and taxpayer cannot provide proof of filing for the original. There is no statute of limitation on the proposed liability resulting from the calculation of taxpayer's liability based on the $400,000 taxable income shown on the amended return. However, the statute of limitation on the proposed liability resulting from the $100,000 federal change begins on June 30, 2008(the date "notification" given to the Department).

D. Notice of Deficiency – Federal Changes

An NOD must be issued within 2 years after a federal change return is filed. If a taxpayer fails to notify the Department where notification is required by IITA §§ 304(c) or 506(b), or fails to report a change or correction as if it were a deficiency for federal income tax purposes, then:

- An NOD may be issued:
  - At any time or
  - On or after August 13, 1999:
    - For any taxable year in which the taxpayer may carry an Article 2 credit, or IITA § 207 loss, earned, incurred, or used in the year for which the notification is required.
    - The deficiency is limited to the amount resulting from recomputing the taxpayer's net income. The deficiency may be assessed on an NOD issued under this provision. The deficiency cannot exceed the results from the federal change.

IITA § 601(a) refers only to the "return," and does not mention amended returns. Accordingly, it is referring only to original returns. Badaracco v. Commissioner, 464 US 386 (1984) and Hillsboro National Bank v. Commissioner, 460 US 370 (1983). If payment was not due before the federal change report was due, no interest would accrue prior to that date.

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A taxpayer who timely files a federal change return and pays the additional tax due is not subject to a late-payment penalty imposed on that amount under UPIA § 3-3(b)(1), (b-5)(1), (b-10)(1), (b-15), or (b-20)(2), whichever is applicable. The statute literally exempts the taxpayer from penalty if the return is timely filed, but the Department's policy is to require timely payment as well.

E. Federal changes/Increase

The taxpayer must report to Illinois any change to its federal income tax liability, which also changes its base income allocable to Illinois.

- Notification shall be made to Illinois in the form of an amended return, no later than 120 days after the alteration agreement or finally determined for federal income tax purposes.
- If the taxpayer sends the Department a letter stating that a federal audit was completed, the letter does NOT constitute notification to the Department.
- This includes if the taxpayer has attached a copy of the federal audit report to the letter. Ref: IITA § 506(b)

A federal change resulting from a federal audit is often referred to as an `RAR' an acronym for Revenue Agent's Report (the document, which reflects the federal audit changes).

- A federal change is finally determined when a deficiency is paid or assessed and any opportunity to appeal the deficiency is past, whichever occurs first. Ref: Sunshine Letter IT83-0737.
  - The taxpayer may protest a proposed deficiency to the Tax Court within ninety days after the IRS mails the notice of deficiency.
  - The federal change is not final during those ninety days.
  - If a taxpayer has filed a petition in the United States Tax Court to contest a federal Notice of Deficiency, then the federal change has not yet been "finally determined" for Illinois purposes. Ref: Sunshine Letter IT88-0029.

The amended return reflects a proper increase to line 1 but taxpayer offsets the reported increase to line 1 with a corresponding increase to nonbusiness income which results in no tax due. Upon audit, the auditor determines the NB adjustment is not allowable, the Department must issue a NOD for the RAR increase within 2 years of the received date.

When a federal change is unreported, the Notice of Deficiency (NOD) may be issued at any time. Ref: IITA § 905(d) When the federal changes have been reported, the Department has two years from the date the amended return was filed to issue an NOD, if necessary. Ref: IITA § 905(e). IITA § 909(d) requires that a claim for refund must be in writing and filed with the Department on the form prescribed by the Income Tax Regulations.

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Note: It is the taxpayer's responsibility to know and comply with Illinois tax laws. Reliance on an auditor's failure to advise the taxpayer should not, by itself, create a "reasonable cause" argument for the taxpayer's own failure to timely report a federal change and pay any increase in tax resulting from that change. However, the auditor's acceptance of an insufficient report (without informing the taxpayer that it is inadequate) could be construed by a court as creating reasonable cause to abate the penalty or as reflecting a Department policy of allowing informal refund claims.

IITA § 903(a) provides that additional tax shown on returns (including any amended returns) is deemed assessed upon the filing of the return. Interest is statutory under IITA § 1003(b) and deemed assessed when the increase in tax is assessed. UPIA penalties are deemed assessed, too.

An acceptance of an amended (IL-1120-X) return cannot occur until the federal change has been finally determined or accepted for federal purposes. If a portion of the proposed liability is agreed upon (and/or paid) and a portion protested, it is the Department's position that the taxpayer should report the agreed portion to Illinois under IITA § 506(b).

Each member of the group who is an Illinois filer when separate unitary returns are filed must report a federal change that affects the unitary base income of the group. If one member reports the change, but others in the group do not, the statutes remain open for those failing to report the change. Each Illinois filer is viewed as a separate entity and the statutes therefore apply on a separate basis.

Example

For calendar year 2004, Corporations A, B, C and D conduct a unitary business. Corporations A, B and C are all Illinois filers and file their 2004 Illinois Income Tax returns based on unitary apportionment. In April of 2007, an IRS audit increases the taxable income of Corporation D by $1,000,000. Corporation D agreed to the audit by signing Federal Form 870 on April 15, 2007. Under IITA § 506(b), Corporations A, B and C each must notify the Department of the finally agreed change in Corporation D's federal taxable income.

If a combined Illinois return (as allowed by IITA § 502(e)) for years ending 12/31/85 and after was originally filed, the Illinois filers are treated as a single taxpayer for purposes of amendments and assessments. Therefore, the amended return will apply to all members (BUT ONLY THOSE MEMBERS) who filed the original, combined return. REF: IAC § 100.5260(a).

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V. PROPOSED ASSESSMENT/LIABILITY

A proposed assessment is the result of the Department proposing a higher liability than the taxpayer has admitted prior to the expiration of the pertinent statute.

- A taxpayer has the option of either agreeing or disagreeing to the proposal.
- If the taxpayer agrees to the assessment and signs Form IL-870, the proposed assessment then becomes a deemed assessment and the taxpayer must pay the additional liability.

For more information regarding the IL-870 and the procedures for processing audits with agreed and/or paid liabilities, refer to Chapter 20 Income Tax Audit Procedure.

1 If the taxpayer disagrees with the proposed assessment, the Notice of Deficiency shall be sent to the taxpayer in accordance with IITA § 904(a), which reflects the proposed adjustments and the reasons for the adjustments. The taxpayer has 60 days (150 days if the taxpayer is outside the United States) from the date the Notice of Deficiency is issued to either:
   a. File a protest with the Department;
   b. Agree by signing an IL-870; or
   c. Pay the proposed assessment.

2 If the taxpayer does not respond within the specific timeframe the liability is assessed in accordance with IITA §§ 903(a)(2) and 904(d) and a Notice and Demand can be issued under IITA § 902.
   - If taxpayer requests a hearing, the Department's action becomes final 30 days after the mailing of a notice of decision. If within that 30-day period, the taxpayer requests a rehearing on the decision the Department's action becomes final either upon:
     - Its issuance (within 10 days after the rehearing request is received) of a denial of the request or,
     - If such denial is not issued within that 10-day period, upon the Department's issuance (as soon as practicable) of a notice of final decision. Ref: IITA § 908 and IAC § 100.9100(b)(2).

Note: In an audit situation, a taxpayer forfeits its right to protest under IITA § 908 and to request an administrative hearing by signing an IL-870. However, the taxpayer may still file a claim for refund and protest the denial of the claim under IITA § 909.

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For a further discussion of un-agreed audit conclusion procedures, refer to Chapter 20 Income Tax Audit Procedure.

VI. EXTENSIONS

Withstanding the statute of limitations for original returns and reported federal changes, there are extensions available and exceptions to the general statutes.

A. Automatic

The Department has granted an automatic extension of 6 months (7 months for corporations) to file any Illinois income tax return except returns due under Article 7 of the IITA. No application form need be filed by a taxpayer to obtain this extension. (IAC § 100.5020(b)) If a balance of tentative tax is due, the taxpayer should transmit the payment with the appropriate form by the original filing due date in order to avoid the penalty for underpayment of tax (IITA § 1005) and statutory interest (IITA § 1003).

B. IRS Extension granted > 6 mos.

The Department will approve an extension of more than 6 months (7 months for corporations) if an extension of more than 6 months is granted by the Internal Revenue Service.

- For corporations the additional Illinois extension will be one month beyond any approved federal extension of longer than the automatic 6-month extension.
- For all other taxpayers, the additional extension will be for the length of time approved by the Internal Revenue Service.

All taxpayers must attach a copy of the approved federal extension to their return when it is filed.

C. 25% omission from Base Income IITA § 905(b)

Taxpayer omits from base income more than 25% of the amount properly includible.

- An NOD may be issued 6 years from the:
  - Automatic extension date, or
  - The date the return was filed, if filed after the extension date.

- The Department cannot include in the 25% calculation, any amount disclosed in the return or in a statement attached to the return, "in a

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manner adequate to apprise the Department of the nature and amount of such item". Ref: IITA § 905(b)(1)

Note: The period for issuing a Notice of Deficiency may extend past the 6-year period allowed by IITA § 905(b) if the provisions of IITA § 905(f) (extension by agreement) are invoked.

Note: Auditor must obtain management approval for 25% omission.

D. Reportable transactions

Taxpayer fails to include on any return or statement for any taxable year any information with respect to a reportable transaction.

- An NOD may be issued not later than 6 years after the return is filed with respect to the taxable year in which the taxpayer participated in the reportable transaction and is limited to the non-disclosed item. Ref: IITA § 905(b)(2)

E. No return or fraudulent return IITA § 905(c)

If the taxpayer fails to file a return or files a fraudulent return, there is no limitations period for issuing an NOD. Ref: IITA § 905(c).

- If the taxpayer has reasonable cause for failing to file a return (non-filer), the limitations period is 6 years from the extended due date of the return. (UPIA § 3-10(b))
- If the taxpayer has participated in the Voluntary Disclosure Program, the limitations period is 4 years from the extended due date of the return. (UPIA § 3-10(c))
- Any taxpayer who is required to join in the filing of a return for a taxable year <u>ending on or after December 31, 2013</u> and is not included on that return and does not file its own return is deemed to have failed to file.
  - The amount of any proposed assessment is limited to the amount of increase in liability that should have been reported from proper inclusion on the return. Ref: IITA § 905 (c)

If a taxpayer files a fraudulent return, there is no limitations period for issuing an NOD. (IITA § 905(c)).

- If a fraudulent return is filed, the subsequent filing of a non-fraudulent amended return does not cause the running of any limitations period to begin. Badaracco v. Commissioner, 464 U.S. 386 (1984)

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F. Erroneous refunds IITA § 905(g)

If an erroneous refund of tax has been paid:

- An NOD may be issued:
  - At any time within 2 years from the making of such refund, or
  - Within 5 years from the making of such refund if it appears that any part of the refund was induced by fraud or the misrepresentation of a material fact.
    - The deficiency is limited to the amount of such erroneous refund.

Note: Beginning July 1, 1993, in any case in which there has been a refund of tax payable under the IITA attributable to a net loss carryback as provided for in IITA § 207, and that refund is subsequently determined to be an erroneous refund due to a reduction in the amount of the net loss which was originally carried back, a notice of deficiency for the erroneous refund amount may be issued at any time during the same time period in which a notice of deficiency can be issued on the loss year creating the carryback amount and subsequent erroneous refund. The amount of any proposed assessment set forth in the notice shall be limited to the amount of such erroneous refund.

G. Request for prompt determination of liability

Certain taxpayers may request in writing for prompt determination of liability. In this situation, the Department must issue a Notice of Deficiency within 18 months after such written request is filed with the Department, but not more than 3 years after the automatic extension date or the date the return was filed, if filed after the extension date. Under IITA § 905(i) the taxpayers to whom this section applies are:

- A decedent or his estate during the period of administration,
- A corporation which notifies the Department that:
  - It is contemplating dissolution at or before the expiration of the 18-month period.
  - It is beginning the dissolution in good faith before the expiration of the 18-month period, AND
  - The dissolution is completed.

H. Transferee liability

An NOD may be issued to a transferee relative to a liability asserted under IITA § 1405 during time periods defined as follows:

- Initial Transferee.

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- Up to 2 years after the expiration of the period of limitation for assessment against the transferor, except:
  - If a court proceeding for review of the assessment against the transferor has begun, then up to 2 years after the return of the certified copy of the judgment in the court proceeding.

- Transferee of Transferee.
  - Up to 2 years after the expiration of the period of limitation for assessment against the preceding transferee, but not more than 3 years after the expiration of the period of limitation for assessment against the initial transferor, except:
    - If before the expiration of the period of limitation for the assessment of the liability of the transferee, a court proceeding for the collection of the tax or liability in respect thereof has been begun against the initial transferor or the last preceding transferee, as the case may be, then the period of limitation for assessment of the liability of the transferee shall expire 2 years after the return of the certified copy of the judgment in the court proceeding.

I. Notice of decrease in net loss IITA §905(n)

On and after August 23, 2002, no NOD shall be issued as the result of a decrease determined by the Department in the net loss incurred by a taxpayer in any taxable year ending prior to December 31, 2002 under ITTA § 207, unless:

- The Department has notified the taxpayer of the proposed decrease within 3 years after the return reporting the loss was filed, or
- Within one year after an amended return reporting an increase in the loss was filed, provided that in the case of an amended return, a decrease proposed by the Department more than 3 years after the original return was filed may not exceed the increase claimed by the taxpayer on the amended return.

VII. LOSS REDUCTION "LR" PROCEDURE

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Audits in which no additional liability is established, but adjustments are made that reduce a claimed net operating loss or excess credit amount should be considered Loss Reduction (LR) audits.

If the auditor is correcting an Illinois net loss (INL) or tax credits for a year in which there is no tax liability, and the taxpayer agrees with the changes, the auditor must obtain a signed amended return (not an IL-870) to correct the INL or credits. The taxpayer will then carry over the correct amount of INL or credit based on the amended return. If the taxpayer does not agree with the auditor's changes for years in which there is no tax liability due, then the taxpayer should be given an EDA-143-LR Net Loss and Credit Reductions. This letter provides written notification to the taxpayer that the Department does not agree with the return(s) as filed.

The taxpayer should understand that signing the letter does not indicate agreement with the Department's position; it is merely proof that the taxpayer was notified of the changes made to the INL or credit available for carryover. The taxpayer will have the right to protest any change in the carry year in which the adjustment to the loss/credit will create a deficiency. Refer to Chapter 20 and 35 for complete procedures.

For purposes of this section:

1. The term "closed year" refers to any year for which the statute of limitations for issuing notices or filing claims has expired.

2. The term "open year" refers to any year for which the statute of limitations for issuing notices or filing claims has not expired.

3. The term "barred deduction(s)" refers to any deduction on a return for a closed year.

4. The term "Article 2 credit(s)" refers to any or all of the various tax credits provided for in IITA Article 2, i.e., Replacement Tax Investment Credit (RTIC), Training Expense Credit, etc.

5. The term "loss" refers to either a federal net operating loss or an Illinois Net Loss unless specified otherwise.

If a loss is incurred in a closed year and was used to offset income in one or more open years the Department may examine the closed loss year to determine the correct amount of loss which may be carried (i.e. the apportionment percentage, addition and subtraction modifications, business and non-business income classification of the loss year), and the loss may be reduced or eliminated. The Department however, may not examine the loss year to

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determine if the unitary filing or the composition of the unitary group was appropriate or correct. 40 Ill. Reg. 10925

If a claim is filed to carryback a net operating loss and the 3-year statute of limitations for issuing a Notice of Deficiency based on the original return for the carryback year has expired any item of income, modification, allocation or apportionment on the claim (even if the item claimed is on the original return also) may be examined, including the determination of whether unitary filing is appropriate or if the unitary group composition is correct. If any portion of the claim is found to be incorrect, the claim may be reduced to zero or the amount of the erroneous refund may be recoverable, but no additional liability may be proposed.

A. VARIOUS EXAMPLES

1. Eliminate INLD

Corporation ABC filed a calendar year 2002 IL-1120 reporting an Illinois Net Loss of $100,000 on October 15, 2003. ABC carried the INLD forward on its original return for 2003, which was filed October 15, 2004.

In February of 2007, an audit was performed on ABC's 2003 IL-1120. No adjustments were made to the 2003 return as filed except that, as part of the audit, the 2002 Illinois Net Loss was examined and it was determined that ABC overstated its US interest subtraction in 2002. If the US interest subtraction had been correctly reported, ABC would not have incurred a loss in 2002. Instead, ABC should have reported Illinois net income of $20,000. The INLD that was carried forward to 2003 was eliminated and a liability proposed for 2003. No liability was proposed on the $20,000 of income, which was reported on the 2002 return since the statute of limitations for issuing a Notice of Deficiency on 2002 had expired.

A taxpayer may also create or increase a loss in a closed year for any reason including a change in the unitary status or composition of the unitary group. The Department's prohibition against changing the unitary status or group composition in a closed year is based upon a Director's Policy Decision, dated May 29, 1986. This decision does not, however, bar a taxpayer from making a similar adjustment in a closed year to determine the proper amount of loss, which is available to be carried into an open year.

IRC Revenue Ruling 56-285 and Springfield Street Railway Co. v. U.S., 312 F.2d 754 (Ct. Cl. 1963) support the position a loss can be increased, decreased, created or eliminated in a closed year.

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2. **Extension by agreement/IL 872 IITA § 905(f)**

Before the expiration of the time set in IITA § 905 for issuance of a NOD, both the Department and the taxpayer can consent in writing to extending the date the Department may issue an NOD.

- Such NOD may be issued at any time prior to the expiration of the period agreed upon.
  - In the case of a taxpayer who is a partnership, Subchapter S corporation, or trust and who enters into an agreement with the Department pursuant to this subsection on or after January 1, 2003, an NOD may be issued to the partners, shareholders, or beneficiaries of the taxpayer at any time prior to the expiration of the period agreed upon.
    - Any proposed assessment in the notice shall be limited to the amount of deficiency resulting in re-computation of income, deduction, credits, or other amounts of the taxpayer that are taken into account in computing its liability.

The period agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon. See discussion on Form IL-872, Consent to Extend the Time to Assess or Refund Income Tax below.

3. **Form IL-872, Consent to Extend the Time to Assess or Refund Income Tax**

If Form IL-872 is properly executed **prior** to natural statute expiration for a tax period, the extended date is the agreed upon date and the entire return is open for auditing purposes. . Ref: IITA § 905(f)

See Chapter 20, Audit Procedures for additional information

Any change made on the IL-872 must be initialed and dated by both the taxpayer and the Department for the change to be valid.

- For the Department, the Director's initials and the date should be placed next to the change by a member of management who has the authorization to affix the Director's signature to IL-872's.
  - Failure to affix the Director's signature prior to expiration of the statute of limitations could result in invalidation of an assessment.
  - That person's initials or authorization number should appear next to the Director's initials.
  - Auditors must not sign waivers or initial any changes on the IL-872.

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Under IAC § 100.5220(b), the designated agent of a unitary business group filing a combined Illinois return will sign the IL-872 in its name and this signature is binding on all other electing members.

Public Act 92-0846 amended IITA § 905(f) to provide that a partnership, Subchapter S corporation, or a trust who executes an extension with the Department **on or after January 1, 2003**, will also extend the statute of limitations for **partners, shareholders, or beneficiaries** of the flow-through entity.

- However, any assessment shall be limited to the amount of the deficiency resulting from recomputing income, deduction, credits, or other amounts of the taxpayer that are taken into account by the partner, shareholder, or beneficiary in computing its liability under the IITA.
- If the taxpayer files an amended return from an RAR or other federal change, it re-opens the statute for that tax period for two years from the date the amended return is filed.

Important: Keep in mind who is signing the IL-872. If a POA is signing, make sure the POA has been given that authority on the IL-2848.

- Similarly, prior to its expiration, such extended period may be successively further extended for any or all of such taxable years by obtaining additional Forms IL-872.
  - If upon being requested to do so, the taxpayer delays or declines or for other reason fails to execute and furnish Form IL-872 for a taxable year or years which otherwise soon would become barred, the Department's recourse ordinarily is to issue a notice of deficiency, which is timely and within previously extended periods under IITA § 905, setting forth adjustments and reasons. Ref: IITA § 904(c).

  - If the Department has not requested Form IL-872, a taxpayer can prevent the expiration of the statutory period during which a credit or refund may be made in connection with items he specifies therein by filing a claim for refund in accord with IITA § 909(d) within the time limitations imposed in IITA § 911. Ref: IAC §100.9400 and 100.9410

Example 1:

On January 3, 2003 Partnership A signed and the Department executed Form IL-872, (Consent to Extend the Time to Assess or Refund Income Tax) to

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extend the statute of limitation for the 1999 tax year until June 30, 2004. A notice of deficiency must be issued to the partners by June 30, 2004 for any adjustments from recomputing of Partnership A's income, deduction, credits, etc. that could be assessed to the partners.

Example 2:

An auditor is auditing Partnership B for calendar years 1998 and 1999. On April 1, 2002, the auditor secured a waiver for B's 1998 tax year, extending the statute of limitations through June 30, 2003. On February 1, 2003, the auditor secured an additional waiver which extended Partnership B's statute of limitations through June 30, 2004 for calendar years 1998 and 1999. Since the initial waiver for Partnership B's 1998 year was obtained prior to January 1, 2003, it does not extend the statute of limitations for B's individual partners for the 1998 tax year. However, a notice of deficiency may be issued to the individual partners for the 1998 year if the auditor had previously secured a waiver for the individual partners. Because partnership B's initial waiver for the 1999 tax year was obtained after January 1, 2003, it will allow the Department to issue a notice of deficiency to B's partners for the 1999 tax year.

VIII. LIMITATIONS ON CLAIMS FOR REFUND

A. Claim Statute- General

A claim for refund cannot occur after:

- The expiration of the 3-year period after the date the return was filed, or
- One year after the date the tax was paid.
  - If the claim is filed within the 3-year limitations period, the refund is limited to the amount of tax paid within the period prior to the claim filing date equal to 3 years plus any extension of time for filing the original return. IITA § 911(d)(1). Accordingly, if the taxpayer files its original return 1 year after the due date, a refund claim filed within 4 years after the due date would be timely, but no refund of amounts paid by the original due date would be allowed. For purposes of this provision, any amount paid before the due date for payment (i.e., March 15 for a calendar year corporation) is deemed to have been paid on that date. (IRC § 6513(b))
  - If the claim is filed within the 1-year limitations period, the refund may not exceed the amount of tax paid within 1 year prior to the filing date.

B. Federal Changes/Decrease

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IITA § 506(b) discusses federal changes and requires taxpayers to notify the Department of such changes by filing an amended return within 120 days after the change is finalized (agreed to, or finally determined) with the IRS or the resulting refund is paid, whichever occurs first.

- A federal change may result from an IRS adjustment to the taxpayer's federal return,
- An IRS audit examination (RAR), or
- The taxpayer filing a federal amended return accepted by the IRS.

For Illinois purposes, the taxpayer is obligated to report the federal change whether or not it creates a change in Illinois income tax liability.

- When the federal change results in an overpayment, IITA § 911(b) allows a refund claim to be filed for that overpayment at any time within 2 years after the federal change notification is due.

Situations may arise where a taxpayer gives an auditor a copy of the federal RAR or summary work papers for inclusion into the audit. This does not meet the requirements for reporting a federal change that increases tax or for claiming a refund. IAC § 100.9200(a)(4) gives the procedures for reporting a federal change. This regulation also provides guidance on when a federal change (RAR) is considered finalized for reporting purposes under IITA § 506(b).

- The two-year statute of limitations to issue a Notice of Deficiency also commences to run on the "received date" of the return. Ref: IITA § 905(e)
  - An executed Form IL-872 may be obtained to extend the statute of limitations on a federal RAR if necessary.

C. Forms Required

IITA § 909(d) states that every claim for refund shall be filed with the Department in writing in such form as the Department may by regulations prescribe, and shall state the specific grounds upon which it is founded.

Example 1

Corporation A has an automatic extension through October 15, 2008 to file its IL-1120 for the year ended December 31, 2007. Corporation A files its 2007 return on June 30, 2008. Corporation A has until October 15, 2011 to file a claim for refund on this original return.

Example 2

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Corporation A filed timely IL-1120's for the calendar years 2000, 2001 and 2002. In 2009, an Illinois audit is performed on the 2000, 2001 and 2002 IL-1120's due to the finalization of a federal RAR. The Illinois audit resulted in a proposed liability for each year of $10,000, $20,000 and $30,000, respectively. On April 24, 2009 Corporation A paid the entire audit liability of $60,000.

For the calendar year 2003 Corporation A incurred a federal net operating loss which (for Illinois purposes) was never carried either back or forward to offset income. Corporation A would have until April 23, 2010 to file a claim carrying back the 2003 NOL to 2000 and offsetting up to $10,000 in tax for that year. The claim could not reduce the 2000 tax liability by more than $10,000.

Example 3

A claim postmarked September 15 and physically received by the Department on September 18 would be "deemed filed" by the Department on September 15.

If the taxpayer has evidence that its claim for refund was, in fact, postmarked earlier than the date the Department has recorded as the filing date The evidence may be submitted by the taxpayer to substantiate timely filing. This evidence can be in the form of a certified mail receipt or some other persuasive evidence sufficient to indicate the postmark date.

D. IL 872- Claim for refund

Under IITA § 911(c) and the instructions on Form IL-872, a claim for refund may be filed within 6 months after the date stated on the IL-872. For information regarding the acceptability of telefaxed IL-872's, refer to Chapter 20.

IAC § 100.9400(f)(2) specifies the date on which the Department will consider a claim for refund as having been filed.

- When filing a claim for refund, taxpayer should attach two photocopies of page one of the claim being filed and request in writing that one photocopy be date-stamped and returned to the claimant as a receipt.
- Upon receipt of the claim, the Department's designee will stamp the photocopies with the Department's Date Received Stamp and initial it for validation purposes.
  - One receipted photocopy mailed to the claimant.

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- If no such validated photocopy is attached to the claim form, or if there is any dispute over the actual filing date, the taxpayer will have to provide proof of timely mailing. Therefore, a claim may have two actual filing dates:

  a) The actual filing date based on the postmark date (envelope date).

  b) The date ten days prior to the date the claim was received by the Department, if the claim was received without a legible postmark affixed to the envelope. This date is called the "deemed filing date" and is the date that is retained in the Department's records for claims. Ref: IAC § 100.9400(f)(2).

E. Unitary business groups

Under IAC § 100.5220(b), the designated agent of a unitary business group filing a combined Illinois return will sign the IL-872 in its name and this signature is binding on all other electing members.

F. Composite returns procedures

When obtaining a waiver (IL-872) for an IL-1023-C return, it is not necessary to get two separate waivers for the entity and the IL-1023-C filer.

Only one waiver is needed with a note on its face for both the entity (IL-1065, IL-1120ST, IL-1041, etc.) and the 1023-C. The same FEIN is used for both return types, therefore the entity and IL-1023-C could be in parenthesis following the FEIN.

Note: IL-1023-C will no longer be used for tax years ending on or after December 31, 2014

G. Notice of Claim Denial (Notice of Proposed Claim Denial)

For claims filed with the Department on and after July 1, l983 which the Department has failed to approve or deny the claim within 6 months from the date the claim was filed may be protested. On or after July 1, 2013, a protest with the Illinois Independent Tax Tribunal may be filed for matters subject to the jurisdiction of the Tax Tribunal. Ref: PA 83-818 and IITA § 909(e)

Per IITA § 909(f), if the Department denies a claim in writing prior to the 6-month period, the taxpayer has 60 days after the issuance of the notice

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of denial to file a protest or a petition with the Tax Tribunal as provided by IITA § 910(a).

- If a protest is filed the Department will:
  - Review the claim,
  - If requested, grant the taxpayer a hearing within 6 months after the date such request is filed.

Per IITA § 909(g), an overpayment of tax shown on the face of an unsigned return shall be considered forfeited to the State if after notice and demand for signature by the Department the taxpayer fails to provide a signature and 3 years have passed from the date the return was filed.

Note: The Department will not accept a protest filed with a claim as timely. The protest is premature if filed prior to a denial of the claim or expiration of the six-month period. Ref: Sunshine Letter IT83-0112..

H. Separate Accounting/Special Apportionment

For the 1988 tax year and after, the instructions on the form IL-1120 figuring income allocable to Illinois were amended to read the following:

- If you fail to provide complete apportionment and allocation information, we will consider 100 percent of business income being attributable to Illinois for taxation purposes.

Note: If a taxpayer files an original return reporting zeroes for all financial information, the taxpayer is treated as having filed an original return.

Important: When auditing a non-filer, verify the legitimacy of payments made under IITA § 601(b)(2) (estimated payments made pursuant to Article 8 and 602(a) (extension payments made pursuant to Section 505).

- If a return is not filed within 3 years of its due date relative to the taxable year which payments are made the taxpayer must forfeit any overpayment subsequently discovered for this taxable year when a return is finally filed. Ref: IITA § 911(f)

For more information regarding the forfeiture of excess payments, refer to Chapter 20.

IX. STATUTORY CONTROL

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Recognizing applicable statutes of limitation and insuring the correct control over them should be a primary concern of all auditors and their supervisors. If statutes expire on cases under audit, disciplinary action can result. When statutes are in jeopardy of being lost, the supervisor should be notified immediately. **It is the Revenue Auditor Supervisor's (RAS) primary responsibility for monitoring statutes to ensure that no periods are lost to the statute of limitations on any cases.**

TAXPAYER'S STATUTE OF LIMITATIONS		
INCOME TAX	**STATUTE**	**CITATION**
-	-	-
ORIGINAL RETURNS		-
Overpayments consisting of estimated payments, extension payments or withholding payments	Within 3 years of the extended due date of the original return.	IITA § 911(f)
Admitting to tax liability	May be filed at any time	
AMENDED RETURNS		
Amended Return-State-Increase	May be filed at any time	
Amended Return-Federal Changes-Increase	TP must file and pay within 120 days of federal finalization (RAR) to not be penalized.	IITA § 506(b) IITA § 905(e)
Amended Return-Claim for Refund	3 yrs. from date original return was filed, or from the extension date, whichever is late	IITA § 911(a)(1), (e)
	1 yr. after the date the tax was paid*	
	Date agreed to on IL-872 (usually 6 months after last date to issue NOD)	IITA § 911(c)
Amended Return-Federal Changes-Decrease	TP must file within 2 yrs. & 120 days of federal finalization date (RAR) OR within dates shown for "Amended Return - Claim for Refund" shown above	IITA §§ 911(b)(1), 909(d), 506(b)
Amended Return-FNOLs occurring before December 31, 1986	3 yrs. from the automatic extension date for the loss year return	ITTA § 911(a)(1)
(apply to claims for refunds due to carry back of Federal NOL)	2 yrs. & 120 days from the date the carryback is finalized for federal purposes	IITA § 911(b)
	3 yrs. & 120 days from the end of the loss year if no loss for federal purposes	IAC § 100.5030(b)
	or w/in dates shown for "amended return - claim for refund" shown above	

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Amended Return-Illinois Net Loss Carrybacks	3 yrs. from the automatic extension date of the loss year return	IITA § 911(g)
	Extension period agreed to on Form IL-872 for the loss year (usually 6 months after last date to issue NOD)	IITA § 911(c)
Notice of Claim Denial-Amended Returns	If Dept. has failed to approve or deny claim within 6 mos. from date claim was filed, TP can file a protest	IITA § 909(e)
	If Dept. denies claim, TP has 60 days after issuance of denial notice to file protest	IITA § 909(f)
DEPARTMENT'S STATUTE OF LIMITATIONS FOR ASSESSING ADDITIONAL TAX OR DENYING CLAIMS		
INCOME TAX	**STATUTE**	**CITATION**
ORIGINAL RETURNS		-
Notice and Demand-Original Returns	No later than 3 yrs. from the date the return is filed	IITA §§ 902(a) & 903(a)(1)
(CAN NOT BE EXTENDED BY IL-872 BECAUSE IT IS AN ADMITTED LIABILITY)		
Notice of Deficiency-Original Returns	Must be issued within 3 yrs. of the date the return was filed or the automatic extension date, whichever is later	IITA § 905(a), (h)
	Anytime within extended time period of IL-872, if signed prior to expiration of the time period allowed	IITA § 905(f)
Notice of Deficiency-Non-Filer	No statute of limitations for assessing a liability	IITA § 905 (c)
	If TP able to show reasonable cause, no tax assessed for periods more than 6 yrs. after original due date*	**As of Jan 1, 1993, UPIA § 3-10*
	If TP voluntarily discloses failure to file, and its approved, no tax assessed more than 4 current yrs. after due date*	**As of Jan 1, 1993, UPIA § 3-10*
AMENDED RETURNS-ADDITIONAL LIABILITY		
Notice and Demand-Amended Returns-State Increase	No later than 3 years after the return is filed	IITA § 902(a)
(Must be issued if TP reported and payment was not received with Amendment)	-	-
(CANNOT BE EXTENDED BY IL-872 BECAUSE IT IS AN ADMITTED LIABILITY)		

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Notice of Deficiency-Amended Returns-Federal Changes-Increase	Must be issued for additional amount within 2 yrs. after the date AMENDED RETURN FILED or within 3 years after original return filed/2 years after erroneous refund, if later	IITA § 905(e)
(Must be issued if additional increase of liability due to federal change)	**3 years after original return/2 years after erroneous refund periods have expired, the deficiency that may be assessed is limited to the federal change	
	Anytime within extended time period of IL-872, if signed prior to expiration of the time period allowed	
Notice of Deficiency-Unreported Federal Changes-Increase	Notice can be issued at any time	IITA § 905(d)
	**3 years after original return/2 years after erroneous refund periods have expired, the deficiency that may be assessed is limited to the federal change	
DEPARTMENT'S STATUTE OF LIMITATIONS FOR ASSESSING ADDITIONAL TAX OR DENYING CLAIMS		
INCOME TAX	**STATUTE**	**CITATION**
AMENDED RETURNS-CLAIM DENIAL		
Notice of Claim Denial-Amended Return-State Decrease	Must be issued within 3 yrs. of automatic extension date*	IITA § 905(a), (h)
	Must be issued within 3 yrs. the date the return was filed, if filed after the extension date*	
	Anytime within extended time period of IL-872, if signed prior to expiration of the time period allowed	IITA § 905(f)
	If above periods have expired, claim can be reduced to zero at any time	Lewis v Reynolds, 284 US 281, 52 Ct, 145 (1932)
Notice of Claim Denial-Amended Return-Federal Decrease		
IF REVIEW RESULTS IN LIABILITY DUE INSTEAD OF O/P	Must be issued for additional amount within 2 yrs. after the date AMENDED RETURN FILED or within 3 years after original return filed/2 years after erroneous refund, if later	IITA § 905(e)
(Must be issued if additional increase of liability due to federal change)	**After 3 years after original return/2 years after erroneous refund periods have expired, the deficiency that may be assessed is limited to the federal change	

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	Anytime within extended time period of IL-872, if signed prior to expiration of the time period allowed	
IF REVIEW RESULTS IN LESSER O/P OR $0	If above periods have expired, claim can be reduced to zero at any time	Lewis v Reynolds, 284 US 281, 52 Ct145 (1932)

A. Mandatory audits

Mandatory audits are those cases where the previous audit produced an established liability [redacted].

Audit Planning Section will generate a follow-up assignment from the end of the prior audit period. Audit Planning will enter the beginning audit period and statute date in GenTax.

Management is to ensure that no periods are lost to the statute of limitations on such cases. If any waivers are secured, GenTax should be updated to reflect the new expiration date.

Copies of all waivers are to be maintained by immediate supervisors until the audit is completed.

Should Management foresee the possibility of lost audit periods on mandatory audits, they should attempt to reassign such accounts within the field office. If this is not possible, the Division Manager is to be notified at the earliest possible date to allow for transfer of accounts to another field office prior to statute expiration.

B. Non-mandatory audits

All non-mandatory cases (i.e. Inventory Selection, Referrals, and Field Requests) are assigned on a First-In, First-Out basis (FIFO). Exceptions to this are geographical areas and auditor-level classification.

In the case of non-filers, it will be necessary for the auditor to commence the assignment in order to determine the beginning of the audit period. Once this determination is made, this date is to be entered in the appropriate GenTax field.

If there is no statute of limitations, 12/31/9998 should be entered in the GenTax statute date field.

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C. **Audit procedure**

There must be four months of statute remaining on a completed income tax audit prior to transmittal to the Income Tax Technical Review Section in Springfield.

In addition, make sure to allow sufficient lead-time to follow the Informal Conference Board (ICB) procedures that are in Chapter 20. Income Tax Audit Procedure.

A waiver of statute of limitations for all Income Tax audits is required no later than four months prior to the expiration of the statute of limitations.

If you cannot secure the waiver before above-stated period, all audits are to be transmitted to Income Tax Technical Review.

Once received by Income Tax Technical Review Section or Audit Perfection Section with the required four months left on the statute, responsibility for securing subsequent waivers lies with these sections.

1. General

An amended return reporting an increase to a tax liability, which is not due to a federal audit, may be filed at any time. An amended return reflecting a reduction in Illinois tax liability is referred to as a claim for refund ("claim"). A claim must be filed with the Department no later than 3 years after the automatic extension date or the date the return was filed, if filed after the extension date, or one year after the date the tax was paid, whichever is later. Ref: IITA § 911(a)(1), 911(e)

X. AMENDED RETURNS

A. **Other State changes**

Under IITA § 911(b), before September 11, 1989 a taxpayer could file a claim for refund within 2 years after the date notification of the state change was due (120 days from the date the change was finally determined or agreed to). Ref: IITA § 506(b)

- After September 11, 1989, deleted from section.

For more information on state and federal changes, refer to Chapter 29

B. **NOLs occurring on or after December 31, 1986**

IITA § 911(g) provides a special statute of limitation on net operating losses (NOLs), which occur in tax years ending on or after December 31, 1986.

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These losses are referred to as Illinois net losses. An Illinois net loss may be carried back any time within whichever of the following expires later:

- 3 years from the automatic extension date of the loss year return, OR
- The extension period agreed to on Form IL-872 for the loss year, plus six months.

For more information regarding the IL-872, refer to the (Extensions - Form IL-872) section.

Example

Corporation A filed its calendar year 1986 Illinois return September 15, 1987. The taxpayer includes a copy of their 6-month federal extension with the return. The return reflected an Illinois net loss, which Corporation A could carryback to 1983. Under IITA Section 911(g), Corporation A has until October 15, 1990 to file an amended return to carryback the Illinois net loss.

On February 15, 1990, Corporation A signs Form IL-872 extending the statute of limitation for the 1986 return to June 30, 1991. Corporation A now has until December 31, 1991 to file an IL-1120-X to carryback the 1986 Illinois net loss.

XI. BANKRUPTCY

The filing of bankruptcy by a taxpayer will not necessarily alter normal audit procedure when an audit is required to establish a tax liability. When necessary, waivers should be obtained to protect the statute. The statutory period of assessment is still valid and does not change as result of the taxpayer filing bankruptcy. However, all work on an audit with a taxpayer in bankruptcy should be completed at least two weeks prior to the bankruptcy claim date.

BANKRUPTCY TRUSTEE

A bankruptcy trustee may submit a tax return during the administration of a case and request a determination of unpaid liability by the governmental unit charged with responsibility for collection or determination of the tax. The trustee, debtor, and any successor to the debtor is discharged from any liability for unpaid tax of the bankruptcy estate if the governmental unit to whom the request was made does not notify the trustee within 60 days of the request that such return has been selected for examination. If the return is selected for examination, the governmental unit must notify the trustee of any tax due within 180 days after the request or within the additional time permitted by the Court.

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XII. ILLINOIS NET LOSS CARRYBACK

PA 88-195 amended IITA §905(g) to state,

> ...in any case in which there has been a refund payable under this Act attributable to a net loss carryback as provided for in IITA Section 207 [i.e. an Illinois Net Loss carryback], and that refund is subsequently determined to be an erroneous refund due to a reduction in the amount of the net loss which was originally carried back, a notice of deficiency for the erroneous refund amount may be issued at any time during the same time period in which a notice of deficiency can be issued on the loss year creating the carryback amount and subsequent erroneous refund. The amount of any proposed assessment set forth in the notice shall be limited to the amount of such erroneous refund.

The amendments to IITA §905(g) which were enacted by PA 88-195 are effective as of July 1, 1993 for all erroneous refunds for which the time period for issuing a Notice of Deficiency for their recovery is still open.

Prior to this legislation if a taxpayer filed a claim carrying back an Illinois net loss and requesting a refund and the refund was issued, the Department had to issue a Notice of Deficiency to recover the amount of the refund which was later determined to be erroneous within 2 years of the date the refund was issued.

If an auditor extended the statute on the loss year but failed to extend the statute on the carryback year (or did not begin the audit on the loss year) within 2 years from when the erroneous refund was issued, the Department was unable to recover any money refunded in error. This required the Audit Bureau to monitor Illinois net loss refund statutes to prevent any revenue from being lost.

Because of the amendment contained in PA 88-195, the Department may recover any money erroneously refunded due to the carryback of an Illinois net loss at any time during the same period for issuing a notice of deficiency on the loss year. If the statute of limitation was extended on the loss year, the statute of limitations for recovering any erroneous refund was automatically extended.

Example

On October 17, 1994, Corporation ABC, a calendar year taxpayer, filed its IL-1120 for 1993 reflecting an Illinois net loss of $100,000. On December 1, 1994, ABC filed an IL-1120X for 1990 carrying back its INLD of $100,000 and

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requesting a refund of $7,300. The refund (plus interest) issued January 15, 1995. Since the Department can examine the 1993, IL-1120 and issue a Notice of Deficiency at any time prior to October 17, 1997. The Department also has until October 17, 1997 to issue a Notice of Deficiency to recover any of January 15, 1995 refund is determined to have been refunded in error due to an incorrect amount of Illinois net loss being carried back. If the statute of limitations for issuing a Notice of Deficiency on the 1993 IL-1120 is extended, the statute for recovering any part of the January 15, 1995 refund determined to be erroneous is automatically extended.

XIII. NOLS AND ARTICLE 2 CREDITS

For more information regarding net operating losses, refer to Chapter 35.

Note: IITA § 207(d) suspended net loss deductions for tax years ending after December 31, 2010 and prior to December 31, 2014. IITA § 207(d) was then further amended to change the suspension to a $100,000 cap on the net loss deduction for tax years ending on or after December 31, 2012, and prior to December 31, 2014.

For more information regarding Article 2 credits, refer to Chapter 36.

When examining net operating losses and Article 2 credits it is important to remember that the statute of limitation provisions of the IITA apply to the issuance of a Notice and Demand, a Notice of Deficiency, a Notice of Claim denial and to the filing of a claim for refund. THERE IS NO STATUTE OF LIMITATIONS ON THE CORRECTION OF A RETURN. Ref: IRS Rev. Rul. 81-87, 1981-1 CB 580, IRC Sec(s). 6402 and 81-88, 1981-1 CB 585, IRC § 6511 respectively.

A. Increase Illinois Net Loss Deduction (INLD) Carry Forward (C/F)

Corporation DEF filed its IL-1120 for calendar year 2002 on October 15, 2003. On its IL-1120 for 2002, DEF reported Illinois income of $50,000 and properly and timely paid the resulting tax liability.

In January of 2007, DEF discovered that their Foreign Source Dividend subtraction had been understated. Correcting the subtraction modification would result in an Illinois Net Loss for 2002 of $20,000. Since the statute of limitations to file a claim for 2002 has expired, DEF cannot request a refund of any liability paid in 2002. However, DEF can correct the 2002 return to reflect the proper amount of Illinois Net Loss. DEF can also file a claim to carryforward the INLD to the 2003 return to offset income and reduce the 2003 tax liability. [Note – again, the years were changed to avoid the limitations on increasing a net loss in IITA § 911(g).

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There is also no prohibition against creating, increasing, decreasing or eliminating the amount of Article 2 credits in a closed year. Again, no deficiency or refund may be established or claimed in the closed year but the proper amount of credits available to be carried into other open years may be determined at any time. This position is supported by IRS Revenue Ruling 82-49, which states; in part the following:

The failure to claim investment tax credit on qualified section 38 property placed in service in a year for which the period of limitations for filing a claim for credit or refund has expired...does not prevent any "unused credit" from the closed year being carried over to an open year...

B. **Unclaimed RTIC**

Corporation GHI files its calendar year 2000 IL-1120 on October 15, 2001. GHI reports a Replacement Tax liability of $10,000 on the 2000 return. In March of 2005, GHI discovers that it should have claimed a RTIC of $20,000 on its 2000 IL-1120. Since the statute of limitations for filing a claim for 2000 has expired, GHI cannot receive a refund of the Replacement Tax paid for 2000. However, GHI can correct the 2000 return to reflect the proper amount of RTIC and excess RTIC available to carry forward to the 2001 return. GHI can then file a claim for 2001 reducing its Replacement Tax liability in that year by the excess RTIC carried forward.

There is also no prohibition against either the taxpayer or the Department correcting the income, factors, credits, etc. in a closed carry year, if no loss or Article 2 credit was ever carried to that year to offset income or claim a refund. The closed year should be corrected to determine the proper amount of loss or Article 2 credits, carried into another carry year for which the statute of limitations is still open for filing a claim or issuing a Notice. This position is supported by numerous federal cases.

C. **Unclaimed Training Expense Credit (TEC) C/F**

Corporation XYZ timely files its calendar year 1999, 2000 and 2001 IL-1120s reporting an Income Tax liability of $30,000, $20,000 and $40,000, respectively. In January of 2005, XYZ discovers that it should have claimed $70,000 of Training Expense Credit in 1999. Since the statute of limitations for filing a claim for refund has expired on 1999 and 2000, XYZ cannot request a refund for those years however, XYZ must still offset the 1999 Training Expense Credit by the $30,000 of Income Tax liability in 1999 and the $20,000 of Income Tax liability in 2000 to determine the amount of credit available to be carried into 2001. XYZ may then file a claim for refund offsetting $20,000 of its $40,000 Income Tax liability by its 1999 Training Expense Credit carryforward.

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During an audit of the 2001 IL-1120 and IL-1120X, it is discovered that XYZ understated its Illinois income and, therefore understated its Illinois tax liability in 2000 by $15,000. Although the statute of limitations has expired for issuing a Notice of Deficiency on the 2000 return, the amount of 1999 Training Expense Credit carried forward to 2001 can be reduced by $15,000 and $15,000 of the 2001 claim for refund can be denied.

XIV. LIENS AND LEVIES

The Department may file a lien for any tax, penalty or interest on all real and personal property of any person assessed with a tax that has neglected or refused to pay the tax after a Notice and Demand has been issued. Ref: IITA § 1101(a)

However, a lien created by such assessment terminates unless the Department files a notice of lien in accordance with IITA § 1103 within 3 years from whichever of the following is applicable:

- The date all proceedings in court for the review of such assessment have terminated. Ref: IITA § 1101(d), 902(b).

- The time for taking the proceedings to court expires without the action taken. Ref: IITA § 1101(d)902(b).

- The automatic extension date or the date the return was filed, if filed after the extension date with the Department. Ref: IITA § 1101(d).

Note: Sunshine Letters IT 93-0083 provide additional information regarding the periods for filing liens.

IITA § 902(c) also provides that the Department may bring a court action for the recovery of taxes at any time within the period allowed by IITA § 1109 to commence proceedings for a levy, regardless of whether a lien has been filed. Under § 1109, a proceeding for a levy cannot begin more than 20 years from the date of filing a notice of lien or if no lien was filed, from the expiration of the three-year statute for filing the lien.

Example

A 2005 return is filed August 12, 2006 (deemed filed on the automatic extension date of October 15, 2006, the three-year statute for filing a lien expired October 15, 1999. However, since IITA § 1109 allows 20 years in which to commence a levy, IITA § 902(c) collection activity may be brought at any time prior to October 15, 2019.

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The Illinois Business Corporation Act (IBCA) of 1983, Section 12.80 (Ill. Rev. Stats, Ch. 32, Para.12.80 (Supp. 1988), currently found under 805 ILCS 5/12.80) however, limit an action against a dissolved corporation. Under that section, an action or proceeding to enforce a civil remedy available against a dissolved corporation for any right or claim existing, or any liability incurred, prior to such dissolution must be commenced within 5 years after the date of such dissolution.

XV. FRAUD

Prior to January 1, 1993, the statute for civil fraud was covered under IITA § 905(c). As of January 1, 1993, Civil Administrative Code (CAC), Section 39c-4 was added by PA 87-1246 and set forth limitation periods for the assessment of taxes by the Illinois Department of Revenue. This section ceased to exist on January 1, 1994 when PA 87-1129 added the exact same language to the UPIA, § 3-10. Each of these sections however, provides that a Notice of Deficiency may be issued at any time if a false and fraudulent return is filed with the intent to evade the tax imposed by any Act.

The statute for criminal fraud is covered under IITA § 1301. This section provides for criminal prosecution of any person who files a fraudulent return. Prosecution for any act in violation of this Section may be commenced at any time within five years of the commission of the act. (Prior to the enactment of PA 82-1009, which was effective September 17, 1982 action had to be commenced within 3 years) Therefore, if a person files a fraudulent return, the Department has five years from the date that return was filed to prosecute the taxpayer. The "date the return was filed" in this instance, refers to the actual date filed and not the date provided under IITA § 905(h). However, if the statute on actual filing has expired, but the deemed date is still open, the Audit supervisor should contact Technical Support for further guidance as the Department may still want to pursue the fraud prosecution.

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NEXUS

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I. PURPOSE OF CHAPTER

The purpose of this chapter is to provide the auditor with the information necessary to determine if an entity and/or its activities have nexus in Illinois, and thus are subject to income taxation based upon these activities.

II. REFERENCES

A. ILLINOIS INCOME TAX ACT (IITA)

IITA § 205(f)
IITA § 304(a)(3)(C-5)(iv)
IITA § 303(f)
IITA § 304(a)(3)(C)(ii)

B. ILLINOIS ADMINISTRATIVE CODE (IAC)

IAC § 100.9720
IITA § 100.3200(a)(C)
IAC § 100.3370(c)(3)

C. CONSTITUTIONAL AND FEDERAL JURISDICITON

Commerce Clause
Due Process Clause
Public Law 86-272

D. COURT CASES

Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951)
Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959)
Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977)
Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940)
Amway Corporation, Inc. v. Missouri Director of Revenue (1990), 794 SW2d 666.
Wisconsin v. William Wrigley Jr. Co. 505 U.S. 214 (1992),
National Bellas Hess v. Department of Revenue - 386 U.S. 753 (1967)
Quill v. North Dakota, 504 U.S.298, (1992)

III. NEXUS DEFINITION

The following definition of nexus is a direct quote from the testimony of Walter Hellerstein before the Subcommittee on Commercial and Administrative Law: Committee on the Judiciary United States House of Representatives. A Hearing on State Taxation: The Role of Congress in Defining Nexus, which was conducted on February 4, 2010.

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> Nexus literally means connection. In the state tax context, nexus generally means the connection that a state must have with a person, property, transaction, or activity in order for a state to exercise its taxing power constitutionally over such person, property, transaction, or activity. Thus the U.S. Supreme Court has said that the Due Process Clause requires "some definite link, some minimum connection between a state and the person, property or transaction it seeks to tax" and that the Commerce Clause requires that a tax be applied only to activities "with a substantial nexus with the taxing state."
>
> The Court has frequently repeated this bedrock principle in a variety of contexts. It has declared that the Due Process and Commerce Clauses of the Constitution do not allow a State to tax income arising out of interstate activities-even on a proportional basis-unless there is a "minimal connection" or "nexus" between the interstate activities and the taxing State…." It has observed that sometimes the nexus question is "whether the State has the authority to tax…at all," and sometimes the nexus question is whether a state that has nexus " with the actor the State seeks to tax" also has the requisite "connection to the activity" that is the subject of the tax. And, in cases in which a state clearly has nexus with the taxpayer and the taxable transaction, such as a use tax-imposed on a state resident, the Court has focused on the "substantial nexus" that the state must have with an out-of-state-vendor to require it to collect the tax.

The determination of nexus for any particular company is important not only in establishing the taxability of the company in Illinois but also in computing the sales factor of the apportionment formula. In order to arrive at the proper amount of throwback sales to be included in the sales factor numerator, the taxability of the company in the sales destination states must be determined. (See new audit manual chapter 27 for the apportionment and throwback of sales.)

IV. NEXUS LIMITATIONS

The states' jurisdiction to tax is subject to three principal limitations.

1. The Federal constitutional limitations of the Commerce Clause and the Due Process Clause;
2. The limitations imposed by the Federal government under its authority to regulate interstate commerce (PL 86-272); and
3. Any limitations a state might itself impose.

A. THE COMMERCE CLAUSE

The Commerce Clause of the U.S. Constitution gives Congress the power "to regulate commerce with foreign nations, and among the several states." The Tenth Amendment to the Constitution provides that any powers not enumerated in the Constitution are

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reserved for the states. The Commerce Clause has been viewed as both a grant of congressional authority and as a restriction on states' powers to regulate.

In the context of nexus the Commerce Clause prohibits a direct tax on the privilege of engaging in interstate commerce. In the Spector Motor Service, Inc v. O'Connor case (1951), The Supreme Court held that such a tax was in violation of the Commerce Clause if applied against exclusively interstate commerce. (see A.M. chapter 49)

In Northwestern States Portland Cement Co v Minnesota, 358 U.S. 450 (1959) the Court held that a state could tax exclusively interstate commerce as long as the tax did not create any effect forbidden by the Commerce Clause. (new audit manual chapter 49) Net income from operations of an exclusively interstate foreign company could be subjected to state taxation provided that:

- The levy is not discriminatory
- The levy is fairly apportioned; and
- A direct net income tax on a foreign company conducting activities within the taxing State forming sufficient nexus to support the tax levied.

In Complete Auto Transit, Inc. v. Brady, 430U.S. 274 (1977), (see audit manual chapter 49) the Court abandoned the Spector Rule. It also rejected the rigid Commerce Clause doctrine that provided the foundation for the Spector rule. Instead, the Court stressed those factors that were pertinent to the validity of a state tax under the Commerce Clause.

The Complete Auto Transit Court developed a four-prong test to determine whether a state tax is constitutional:

1) The tax applied to an activity that has a substantial nexus with the state;
2) The tax is fairly apportioned
3) The tax does not discriminate against interstate commerce.
4) The tax is fairly related to services provided by the state.

If there is a sufficient "contact" or "nexus" between the taxing state and the non-domiciliary taxpayer, and the tax imposed is fairly related to the non-domiciliary taxpayer's in-state activities, the tax will be upheld.

B. DUE PROCESS CLAUSE

The Commerce Clause specifically authorizes Congress to regulate commerce. The Supreme Court has interpreted this as prohibiting the states from enacting laws taxing out of state companies unless there is a substantial connection.

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Unlike the Commerce Clause, the Due Process Clause specifically limits the states power to impose taxes. The Due Process Clause states that no state shall “deprive any person of life, liberty or property, without due process of law”.

The Supreme Court’s case of Wisconsin v. J.C Penney Co., 311 U.S. 435 (1940), is one of the most cited and quoted regarding Due Process. Justice Frankfurter stated:

> That test is whether property was taken without due process of law, or whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask a return. [emphasis added]

C. PUBLIC LAW 86-272

The second limitation to the states' jurisdiction to tax is imposed by the Federal government's authority to regulate interstate commerce. Under the United States Constitution, a state's net income tax (or a tax measured by income) must not unduly burden interstate commerce and must provide, to the taxpayer, due process of law.

Public Law (PL) 86-272 was passed and became law in 1959, as a reaction to a holding by the U.S. Supreme Court that a state could impose a tax on net income of a corporation derived from its activities within the state even though such activities were exclusively in interstate commerce. Northwestern States Portland Cement Co. v. Minnesota, 385 U.S. 450 (1959). REF: I00638.

PL 86-272 applies only to the sale of tangible personal property in interstate commerce. It precludes a state from imposing an income tax upon a person whose activities within a state do not exceed specific limits. This immunity from tax is limited to activities considered to be merely solicitation of orders for the sale of tangible personal property. Activity beyond the mere solicitation of orders can subject an out-of-state corporation to tax.

V. GENERAL LIMITATIONS ON PL 86-272

PL 86-272 affords no protection to a taxpayer who is incorporated in the State into which sales are being made. Also, since PL 86-272 applies only to sales of tangible personal property, it does not pertain to persons whose business activities consist of:

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1. Selling or providing of services;

2. Leasing, renting, licensing or disposition (other than by sale) of personal property;

3. Selling, leasing, renting, licensing or otherwise disposing of real estate, intangibles or any other type of property;

4. Sales which involve a mixture of tangible personal property and services, for example:
   - Photographic development,
   - Fabrication of customer's materials,
   - Installation of equipment, and
   - Architectural and engineering services.

   See Amway Corporation v. Missouri court case in the Audit Manual 37. (new Chapter 49)

   Note: State of Incorporation/Certificate of Authority. The state in which a company is incorporated has the authority to tax that company regardless of the amount of business activity that it conducted in the state. Also, any individual who is domiciled in or a resident of the state is considered taxable in that state.REF: PL 86-272, Sec.101(b).

VI. ILLINOIS INCOME TAX ACT

The third limitation to a state's jurisdiction to tax is any statutory limitation the state chooses to impose on itself. PA 88-361, which became effective August 16, 1993, created Section 205(f) of the Illinois Income Tax Act. This provides that a person not subject to tax under the IITA, will not become subject to the tax by:

- owning property at a printer in Illinois under contract;
- a person's employees at a contracted printer solely for quality control, distribution.

A person under this situation is defined under Section 1 of Title 1 of the US Code as being corporations, associations, firms, partnerships, societies, joint stock companies and individuals.

VII. SOLICITATION

The term "solicitation" is not defined by statute. Illinois interprets the term narrowly by concluding that any activity beyond the mere solicitation of orders will subject an out-of-state corporation to tax.

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The Supreme Courts review of the Wisconsin v. William Wrigley, Jr. Co. case (see court cases, audit manual chapter 49) involved the use of two tests for determining the scope of the term “solicitation” of orders.

1. Solicitation of orders falls "...between those activities...that serve no independent business function apart from their connection to the solicitation of orders (ancillary functions) and those activities that the company would have reason to engage in any way but chooses to allocate to its in-state sales force."

2. A de minimis rule applies for activities which go beyond solicitation of orders, however, "...whether in-state activity other than "solicitation of orders" is sufficiently de minimis to avoid loss of the tax immunity, depends on whether that activity establishes a nontrivial additional connection with the taxing State."

Using these two new rules the Court found that Wrigley’s activities exceeded “solicitation” and, therefore, Wrigley was taxable in the state of Wisconsin.

After the Wrigley decision, Illinois developed regulations on nexus which became effective on June 22, 2001. (See IAC § 100.9720)

IAC § 100.9720(c)(2)(C) defines solicitation as the speech or conduct that explicitly or implicitly invites an order. And, activities that neither explicitly or implicitly invite an order but are entirely ancillary to invitations for an order are considered solicitation. To be ancillary to invitations for orders, an activity must serve no independent function for the seller other than the solicitation of orders.

Activities that do not fall within this definition will cause the company to lose the protection under PL 86-272 unless these activities, taken together are de minimis. Activities are considered de minimis activities when they are taken together and establish only a trivial connection within this State. REF: IAC § 100.9720(c))2)(D)

- An activity conducted in this State on a regular or systematic basis or company policy is not considered trivial.
- An activity will be measured on a qualitative and quantitative basis for consideration of a trivial nature.
- Trivial determination is made on the basis of the taxpayer’s entire business activity, not just Illinois activities.
- An unprotected activity would not be de minimis if it was the only activity in this State.
- Amount of unprotected activities conducted relative to protected activities is not determinative to issue of de minimis.

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- An unprotected activity that would not be deminimis if it were the only activity conducted in this state shall not be deminimis if done with a substantial amount of protected activities.

  Companies in the business of selling tangible personal property whose only connection with Illinois consists of being qualified to do business in the state (i.e. having a certificate of authority to do business in Illinois) have not exceeded the provisions of PL 86-272. REF: Sunshine Letter IT89-0199.

VIII. EXTENDED IMMUNITY – INDEPENDENT CONTRACTORS

Extended immunity exists under PL 86-272 for independent contractors. Independent contractors may not only solicit but approve or reject sales within a state as long as delivery of the merchandise is from an out-of-state location. REF: IAC § 100.9720(c)(6)

PL 86-272 contains its own definition of an "independent contractor" entitled to this extended immunity. Only a "commission agent" who holds himself out as selling goods for two or more principals qualifies for this immunity. A salesman working only for the taxpayer does not qualify, even if he is an independent contractor in the usual meaning of that term.

IX. EXAMPLES OF ACTIVITIES CREATING NEXUS IN ILLINOIS

A complete listing of activities that create nexus is contained within the regulations, these appear in IAC § 100.9720(c)(4)

A. EXAMPLES NOT CREATING NEXUS IN ILLINOIS

A complete listing of activities that do not create nexus is contained within the regulations, these appear in IAC § 100.9720(c)(5).

X. SERVICE TAXPAYERS

Since service taxpayers do not fall under the protection of PL 86-272, preconceived ideas of activities such as solicitation, sales offices, etc. are not governing factors in establishing nexus. A service taxpayer is generally considered to have nexus in Illinois if any of its business or nonbusiness income would be apportioned or allocated to Illinois under the provisions of Sections 301-304 of the IITA.

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Although it would appear that there would be greater latitude in establishing nexus in these cases, the voiding of PL 86-272 protection actually places a much heavier responsibility on an auditor to gather enough data to provide a defendable position in case the taxpayer disagrees with the auditor's conclusion.

Prior to December 31, 2008 Illinois used a cost of performance basis to source sales of service to this state. Cost of performance methodology provides that the sale is assigned to the state in which a greater proportion of the income producing activity was performed. (see Historical Extracts and Appendix section)

For all tax years ending after December 31, 2008, Illinois changed the method of allocating the sales of service from a cost of performance approach to a market based approach. Currently Illinois is one of thirteen states that use the market based sourcing approach for the allocation of sales of services in the computation of the sales factor. As of November 1, 2012 the following states used market based sourcing rules:

> **Alabama, Arizona, California, Georgia, Illinois, Iowa, Maine, Maryland, Michigan, Minnesota, Oklahoma, Utah, Wisconsin.**

REF: AICPA Tax Advisor, November 1, 2012.

In the market based approach the sales of services are assigned to the state in which the service is received. (See IITA 304(a)(3)(C-5)(iv))

- Gross receipts from the performance of services provided to a corporation, partnership, or trust may only be attributed to a state where that corporation, partnership, or trust has a fixed place of business
- If the state where the services are received is not readily determinable or is a state where the corporation, partnership, or trust receiving the service does not have a fixed place of business, the services shall be deemed to be received at the location of the office of the customer from which the services were ordered in the regular course of the customer's trade or business.
- If the ordering office cannot be determined, the services shall be deemed to be received at the office of the customer to which the services are billed.

IITA § 304(a)(3)(C-5)(iv) contains a “throw out” provision that provides that if the taxpayer is **not taxable** in the state in which the services are received, the sale must be excluded from both the denominator and the numerator of the sales factor.

(Refer to audit manual new chapter 27, apportionment for discussion of this topic)

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A. FOREIGN TREATY SITUATIONS

IAC § 100.3200(a)(C) describes the treatment of sales conducted in a foreign country. In a foreign country or political subdivision of a foreign country the determination of whether a state has jurisdiction to subject the taxpayer to a net income tax will be treated as if it were a state of the United States or political subdivision thereof. If a person is not required to pay a net income tax by a foreign country as the result of a treaty provision exempting certain persons, business activities or sources of income from tax then this person is considered not subject to tax. For the purposes of services, this income would be thrown out of the denominator under IITA § 304(a)(3)(C-5)(iv).

XI. OUT-OF-STATE FRANCHISERS

The franchiser typically receives payments from a franchisee for the right to use a name, as well as for guidance as to the management of the business and for accounting services. The fact that a franchiser does not fall under the protection from state taxation under PL 86-272 does not necessarily mean that performance of these services within the state will automatically constitute nexus. Nexus is not a clearly defined issue and all the facts must be examined closely.

IAC § 100.9720(c)(4)(R) states that the following are unprotected activities under PL 86-272 within Illinois:

- entering into franchising or licensing agreements;
- selling or otherwise disposing of franchises and licenses; or
- selling or otherwise transferring tangible personal property pursuant to such franchiser or licensor to its franchisee or licensee.

Even if nexus is established, the apportionment of some or all of the taxpayer's business income to Illinois, and therefore creation of an Illinois tax liability, will not occur unless the royalty payments can be allocated to Illinois for purposes of the Illinois sales factor numerator using the test contained in IITA § 304(a)(3)(C)(ii) (i.e. location of income producing activity). If the income producing activity is performed wholly within Illinois or if a greater proportion of the activity is performed within Illinois than is performed in any other state (based on costs of performance), the receipts from the franchise would be attributable to Illinois for purposes of the sales factor and an Illinois tax liability could exist. REF IAC § 100.3370(c)(3)

The income producing activity which is associated with the franchise may include such activities as:

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1. Actually receiving franchise royalty payments within the state;

2. Local (in-state) management training courses; and

3. Frequent visits to the franchisee to consult on business matters and occasional visits may create nexus depending upon the nature and length of the visits.

XII. CORPORATE PARTNERS

A corporate partner whose only contact with Illinois consists of an interest in a partnership doing business in Illinois is considered to have nexus in Illinois. This is true regardless of whether the interest is a limited or a general partnership interest. REF: Borden Chemicals and Plastics, L.P. v. Zehnder, 726 N.E. 2d 73, 312 Ill. App. 3d 35 (1st Dist. 2000).

XII. UNITARY BUSINESS GROUPS

Illinois statutes and regulations are based on the application of the Joyce Rule, Ref: IAC § 100.9720(f). When dealing with a unitary group of companies, nexus must be determined for **each** member individually, based on each company's own activities within the state. Even if the unitary group elects to file a combined Illinois return (available for tax years ending on or after December 31, 1985) and, in effect, is treated as one taxpayer in many respects, the taxability of each member of the group is still determined based on that member's activities within the state. This is true because combined apportionment is only an apportionment method; it does not create new Illinois taxpayers.

XIV. HISTORICAL EXTRACTS / EXHIBITS

A. PRIOR TO TYE 12/31/08 SERVICE TAXPAYERS

Section 304(a)(3)(C) states that sales, other than sales of tangible personal property, are in this State **prior to December 31, 2008** if:

- The income producing activity is performed in this State or;

- The income producing activity is performed both within and without this State and a greater portion of the income producing activity is performed within this State than without this State, based on cost of performance.

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Under this provision, nexus would rarely be an issue for a taxpayer deriving all of its income from sales other than sales of tangible personal property. A service provider whose connection with Illinois was small enough to raise the nexus issue would almost never have sufficient income-producing activity in the State to source any of its sales to Illinois, while a service provider who had sufficient income-producing activity in Illinois to source a sale here would almost certainly have nexus.

B. NEXUS RELATED QUESTIONNAIRES

Determining whether a taxpayer has nexus is extremely fact-specific. It is imperative that taxpayer be asked a comprehensive set of questions to establish nexus during the audit. Simply being passive during the audit and asking the taxpayer to demonstrate the non-existence of nexus is an insufficient determination that may not hold up if protested.

Specific activities that go beyond mere solicitation and are unprotected by PL 86-272 are listed within IAC § 100.9720(c)(4). This is one of the areas of focus on the determination of whether or not a company has nexus with Illinois. The nineteen unprotected activities listed in subsection (c)(4)(A)-(S) can be researched by asking the taxpayer specific questions on these activities; using a questionnaire such as the **Multistate Tax Commission Business Activity Questionnaire.** This questionnaire may be referenced in an internet search simply by searching this title. A brief example is given below and a more comprehensive questionnaire is presented at the end of the chapter.

Example

The unprotected activities described in IAC§ 100.9720(c)(4)(A)-(F) are listed with corresponding question(s) from the MTC Business Activity Questionnaire which are in italics.

- A) Making repairs or providing maintenance or service to the property sold or to be sold.
    - *(13) Service or repair equipment or property of your customers in this state? Yes____ No ____*
    - *(16) Provide your customers in this state with technical information or advice? Yes ____ No ____*
- B) Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.
    - *(18) Collect installments and/or delinquent accounts?*

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Yes ____ No ____

- *(19) Repossess the company's products? Yes ____ No ____*
- *20. Does anyone acting on your company's behalf repossess products in this state? Yes ____ No ____*
- *21. Do employees in this state ever repossess products in this state? Yes ____ No ____*

- C) Investigating credit worthiness.
  - *(20) Investigate, recommend, or appoint potential dealers? Yes ____ No ____*

- D) Installation or supervision of installation at or after shipment or delivery.
  - *(14) Perform any installation or construction work within this state? Yes ____ No ____*
  - *18. Does your company have employees who install your product either by doing the actual installation or by supervising the installation by others?*
  - *Yes ____ No ____*

- E) Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation of sales of tangible personal property.
  - *(16) Provide your customers in this state with technical information or advice? Yes ____ No ____*
  - *10. Does your company perform engineering functions in this state? Yes ____ No ____*

- F) Providing any kind of technical assistance or services, including, but not limited to, engineering assistance or design service, when one of the purposes of the assistance or service is other than the facilitation of the solicitation of orders
  - *(21) Conduct training courses or schools for your customers or dealers? Yes ____ No ____*

Note: For any "yes" answer, the taxpayer should furnish a written explanation. Conduct of activities must still exceed a de minimis threshold, in order for nexus to be established. However, an activity conducted within this State on a regular or systematic basis or pursuant to a company policy (whether such policy is in writing or not) is not normally considered trivial. Ref: IAC § 100.9720(c)(2)(D)

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C. ECONOMIC NEXUS

Illinois has not yet applied the economic nexus theory. Thirty states currently have provisions allowing some form of economic nexus. This section is strictly for informative purposes.

The concept of economic nexus is that a state may exercise its taxing authority over an out- of- state person who has no physical presence in that state but has an economic presence. The value of corporate trade names, trademarks, intellectual properties, intangible properties and services generate income even when there may be no physical presence, employees, or property within a non domiciliary state.

The Supreme Court ruled in 1967 that a state was barred by the Due Process Clause and the Commerce Clause from requiring an out-of-state vendor to collect **use** tax in the state of sale when the only connection was the solicitation of orders through mailed advertisements which orders were then shipped via mail or common carrier. In National Bellas Hess v. The Illinois Department of Revenue and in the 1992 case of Quill v. North Dakota the Supreme Court upheld this prohibition regarding use tax.

However, in Quill the court stated: “With certain restrictions, interstate commerce may be required to pay its fair share of state taxes”, and “ it was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of the state tax burden even though it increases the cost of doing the business.” Quill v. North Dakota, 504 U.S. 298, 310 n. 5. The Court stated that a challenge against the Commerce Clause would be sustained so long as the tax met Complete Auto’s four-part test. (See Complete Auto Transit in Commerce Clause Section above.)

Based on statutes, regulations, court decisions, or administrative announcements there are thirty states that currently allow for some form of economic nexus similar to the Geoffrey v. South Carolina case:

Washington, Oregon, Idaho California, Utah, Arizona, New Mexico, Colorado, Oklahoma, Arkansas, Louisiana, Iowa, Minnesota, Wisconsin, Michigan, Indiana, Ohio, Kentucky, West Virginia, North Carolina, South Carolina, Florida, Maryland, Delaware, New Jersey, New York, Connecticut, Massachusetts, New Hampshire, and Maine.

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With the exception of Arizona, these states also have provisions for economic nexus for financial institutions along with Idaho and New York City. REF Ernst and Young 03/29/2011.

1. Court Cases

There have been numerous court cases involving the issue of economic nexus. Four significant economic nexus cases are listed below with a summary of the issue(s).

- *Geoffrey v. South Carolina Tax Commission*, 437 S.E.2d 13, 18 (1993). The regular exploitation of a states marketplace, without physical presence, should subject a corporation to the states jurisdiction to impose an income tax. The Commerce Clause physical presence requirement established in Quill was not applicable to income tax cases. Additionally, the court held that the presence of intangible property within the state was sufficient to establish nexus.

- *Lanco, Inc v. Dir., Div. of Taxation*, 188 N.J. 380 (2006). The court held that New Jersey could tax the royalties received by a Delaware holding company even though it did not have a physical presence in New Jersey; and, the Quill physical presence test should be limited to sales and use taxes.

- *Tax Commissioner v. MBNA Am. Bank*, 640S.E.2d 226, 234-36(2006). The West Virginia Supreme Court of Appeals held that MBNA had "purposefully targeted the state and had significant economic presence." The court held that the exploitation of the local market through "frequency, quantity and systematic nature of a taxpayer's economic contacts with a state" was sufficient to establish nexus.

- *KFC Corp. v. Iowa Dept. of Revenue*, 792 N.W.2d 308 (Iowa, 2010). KFC, a Delaware corporation domiciled in Kentucky, licensed its trademark to franchisees in various states, including Iowa. The Iowa court held that the Quill physical presence test for sales and use tax did not extend to income tax. Further, the court held that KFC had, "received the benefit of an orderly society within a state" and was therefore subject to taxation. The court held that multiple franchises in Iowa were sufficient to establish the functional equivalent of physical presence.

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2. Attributional Nexus and Affiliate Nexus

In addition to physical presence nexus and the emerging application of economic nexus; attributional nexus and affiliate nexus are being applied by some states on out-of-state sellers and businesses.

Attributional nexus is broader and consists of a state's ability to assert nexus over an out-of-state taxpayer based on the activities of a related or unrelated entity engaging in in-state activities on behalf of the out-of-state retailer.

Affiliate nexus generally requires the existence of common ownership or control between an in-state taxpayer and an out-of-state company in order to create nexus for the out-of-state company.

a) Attributional Nexus

If an out-of-state seller is relying upon the activities of an in-state third party, this may have created nexus by attribution of a third-party's in-state activities when the third party is acting on behalf of the out-of-state seller, and the third party's activities are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales.

The Supreme Court's decisions in *Scripto, Inc v. Carson* and in *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue* have supported court rulings for attributional nexus. In invoking attributional nexus, the physical-presence nexus standard is not limited to the taxpayer's own activities. Income tax collection is based on the in-state activities of others for such activities as warranty repair services. PL 86-272 does not protect an out-of-state marketing company's repair activities in the taxing state. Accordingly MTC Nexus Bulletin 95-1 states the view that provision of warranty repair by a third party acting as agent for the taxpayer exceeds solicitation and is not a protected ancillary activity.

On August 2, 2013 an Illinois Administrative Law Judge (ALJ) supported a ruling in favor of the Department in finding that an out-

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of-state company had Illinois income tax nexus due to the in-state activities of third-parties. The finding affirmed attributional nexus, in part, due to the out-of state company's registration for sales tax, and in part due to the activities of a third-party. The ALJ concluded that "a foreign corporation may be considered 'physically present' in a state because of the physical presence of independent contractors who are soliciting orders for the seller's goods." Ref: *Department of Revenue v. ABC Company,* Office of Administrative Hearings, No.IT13-05.

b) Affiliate Nexus

Affiliate nexus statutes Affiliate nexus is legislatively defined in various states and often includes situations where:

(1) an out-of-state entity sells to in-state customers,
(2) has an in-state affiliate, and
(3)The in-state affiliate uses identical or substantially similar business names, trademark, or goodwill, or sells similar products;

- or the in-state affiliate has a facility or employees to facilitate or promote sales;
- or the in-state affiliate has a warehouse or distribution center;
- or the in-state affiliate performs repair or maintenance services;
- or the in-state affiliate is a member of the out-of-state entity's controlled group.

Under IAC § 150.201(i)(5) Illinois does recognize affiliate nexus in the application of use tax. This section of the IAC provides that a retailer maintaining a place of business can include: being owned by or controlled by the same interests and engage in the same line of business.

3. Factor Presence Nexus Standard

On October 17, 2002 the Multistate Tax Commission amended MTC Policy Statement 02-02 and created a nexus standard for state business activity taxes: Factor Presence Nexus Standard for Business Activity Taxes. The MTC intention was to present a "simple certain and equitable standard for the collection of state business activity taxes." (Multistate Tax Commission) In its adoption of Policy Statement 02-02 the MTC created the definition of factor presence nexus which has five main considerations.

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- The first consideration is to define nexus for resident and non-resident entities. Individuals who reside or are domiciled and business entities who are commercially domiciled have substantial nexus within the state.

- The second consideration is the statement of a monetary benchmark to approximate a financial threshold at which an economic nexus is said to exist.

Nonresident individuals and business entities organized outside the state have substantial nexus and are subject to appropriate business activity taxes when in any tax period property, payroll or sales exceeds any of the following thresholds:

(a) a dollar amount of $50,000 of property,
(b) a dollar amount of $50,000 of payroll,
(c) a dollar amount of $500,000 of sales,
(d) or a 25% of total property, payroll or sales.

- The third consideration defines property payroll and sales including property of both a tangible and intangible nature.
- The fourth area of discussion focuses on UBG's.
- The final area of discussion discusses the protection of PL 86-272 and the lack of a states jurisdiction to tax

Factor Presence Nexus Standard for Business Activity Taxes may be viewed in its entirety by searching the internet using the title.

D. NEXUS QUESTIONNAIRE EXHIBIT

Note: The accompanying questionnaire example is targeted towards three factor, IITA 304(a) apportioning companies. Some questions would be formatted differently to research nexus for non IITA 304(a) companies. (transportation, insurance, and financial entities)

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ILLINOIS DEPARTMENT OF REVENUE
NEXUS QUESTIONNAIRE

For Taxable Years _____ Through _____

Company Legal Name_____ Federal Employer Identification Number

Company DBA_____ (FEIN)_____

1. Does your company, or any affiliated company, now have, or has it at any time had, an office ( ), agency ( ), warehouse ( ) or other place of business ( ) in this state? Y / N

   If "yes", please state for each establishment (use additional sheets if necessary):

   (a) Location:

   _____

   (b) Appropriate beginning date of operation (and ending date if applicable):

   _____

   (c) Nature of the business activity:

   _____

   (d) Telephone number listed in a directory in this state.

   _____

   (e) WATS number for use by caller in this

   state:_____

2. Does your company, or any affiliated company, own or rent real or tangible personal property located or being used in this state? Y / N

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If "yes",

(a) Complete the following schedule for each year included in the audit. Include all items such as: merchandise, inventories, motor vehicles, railroad cars, office equipment, industrial equipment, buildings and land, etc.

YEAR	OWNED	TYPE	RENTED	TYPE
_____	$_____	_____	$_____	_____
_____	$_____	_____	$_____	_____
_____	$_____	_____	$_____	_____

(b) In what name was the aforementioned property licensed or listed for tax purposes?

_____

_____

3. Does your company or any affiliated company lease or rent to others (or has it in the past leased or rented) any tangible property located and/or used in this state (such as motor vehicles, office space, industrial equipment, etc.)? Y / N
If "yes",

(a) Describe said property briefly, and state for what years it was rented or leased.

_____

_____

4. Have you licensed intangible rights for use in this state or sold real estate, services or intangibles in this state? Y / N
If "yes",

(a) Give location, dates and description of property, service or intangibles.

_____

_____

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5. Does your company, or any affiliated company, maintain a bank account in a bank in this state? Y / N

6. Does the company have or has it ever had a security interest in any real or personal property sold or located in this state? Y / N

7. Does the company have or has it ever had advertising material in this state which it owned? Y / N

8. Is your company listed in any telephone or building directory in this state? Y / N

9. Does your company engage or has it engaged in any advertising (cooperative or otherwise) in this state? Y / N

10. Were any contracts ever executed by your company in this state? Y / N
If "yes",

(a) Detail location, dates and value of contracts:

_____

_____

10. Have you had employees or other representatives (such as a broker, manufacturer's agent, etc.) performing services within this state? (If you had employees whose base of operations was in another state, but whose duties includes occasional calls upon customers or clients within this state, answer this question "yes".) Y / N
If "yes",

a) In what year did your employees or other representatives begin performance of these services within this state?

_____

Have these services been performed within this state by your employees or other representatives in every year since then?

_____

If not please explain:

_____

_____

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(b) Identification of employees or representatives: (a separate sheet may be used if additional space is needed).

NAME	ADDRESS	TERRITORY COVERED FOR YOUR COMPANY	DESIGNATE IF EMPLOYEE OR INDEPENDENT CONTRACTOR

If the persons identified above are or were engaged in some form of sales or promotional work on your behalf, please complete items (c-1) through (c-13) below to describe their contacts with the customers.

(c) Do any of these employees or representatives:

1) Call upon customers in this state to collect on delinquent accounts? Y / N

2) Make adjustments for returned or damaged merchandise? Y / N

3) Investigate or authorize credit of existing or potential customers in this state? Y / N

4) Investigate complaints of customers in this state? Y / N

5) Authorize warranty work or replacement? Y / N

6) Receive purchase orders when calling upon a customer in this state? Y / N
If yes, do they have the authority to approve or reject the order? _____

7) Accept returned merchandise from customer in this state? Y / N

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8) Make "on the spot" sales to customers in this state of any items carried by them? Y / N

9) Pick up damaged and/or out-of-date merchandise? Y / N

10) Inspect or have the right to inspect the marketing of your products or any use of your trademarks or tradenames? Y / N

11) Maintain an office of any kind, in a home or elsewhere within this state? Y / N
If "yes", do they:

Store inventory there? Y / N

Store samples there? Y / N

Maintain a telephone listing under the company's name? Y / N

Receive any office expense reimbursement from the company? Y / N

12) Assist your customers or their customers in this state in any of the following ways:

Train their employees in the sale, use or servicing of your products? Y / N

If "yes", where does this take place?

_____

_____

Plan dealer promotions? Y / N

Call on dealers' customers accompanied by dealer's salesmen? Y / N

Inspect dealers' inventories to insure adequacy? Y / N

13) Sell, or represent, other lines of merchandise besides yours? Y / N
If "yes", please explain:

_____

_____

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14) Periodically or occasionally service or repair equipment or property of your customers in this state? Y / N

15) Perform any installation or construction work within this state? Y / N

16) Supervise or inspect the installation of products sold to your customers in this state? Y / N

17) Provide your customers in this state with technical information or advice? Y / N

18) Deliver products sold to your customers in this state? Y / N

19) Accept or secure deposits or down payments? Y / N

20) Collect installments and/or delinquent accounts? Y / N

21) Repossess the company's products? Y / N

22) Perform any inspection of the company's products? Y / N

23) Set up merchandising or advertising displays? Y / N

24) Arrange cooperative advertising agreements with customers? Y / N

25) Conduct lectures, films, etc., promoting or demonstrating company's product or service? Y / N

26) Investigate, recommend or appoint potential dealers, agents or distributors of the company? Y / N

27) Call on dealers' customers accompanied by dealers' salesmen? Y / N

28) Perform engineering functions? Y / N

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29) Conduct training courses or schools for your customers, agents, distributors, etc.? Y / N

30) Provide sales or service manuals to customers, distributors, agents, etc.? Y / N

31) Supervise installation of company's product? Y / N

32) Perform installation, service or repair work? Y / N

33) Handle complaints, trouble shoot or give advice? Y / N

34) Hold meetings? Y / N

35) Reside in this state? Y / N

36) Engage in any other activities not fully explained by the above questions? Y / N
If yes, explain in detail:

_____

_____

_____

_____

(d) How does the company compensate such representatives (commission only, salary and commission, expense allowance, etc?)

_____

_____

(e) Do you have a standard form of written agreement with the representatives? Y / N
If yes, please enclose a copy for our review.

(f) If the salesman's or representative's duties have not been fully covered in the items above, please add sufficient further description as to give a comprehensive description of the services performed.

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_____

_____

_____

(g) How does your customer in this state usually transmit its purchase order to your company?

By mail? Y / N

By handing it to your representative? Y / N

Other (explain)

_____

_____

(h) Does your company ever submit bids to potential customers in this state in which you offer to sell goods or services based upon conditions specified therein? Y / N

(i) How are deliveries made to this state?

By common carrier? Y / N

By your vehicles Y / N

If by your vehicles, are such vehicles owned or leased by your company? _____.

Are deliveries to customers in this state always made from an out of state location? Y / N

If "no", please explain:

_____

_____

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11. Please provide job descriptions of your employees in this state, including:

    (a) Description of position

    (b) Nature and scope of duties.

    (c) Principle accountabilities.

12. Do any affiliated companies engage in any activities in this state that are listed in this questionnaire? Y / N

    If so, indicate each company's name and address and explain the company's activities within this state during each of the seven most recent years.

    _____

    _____

Signature and Verification

I declare that the information furnished in response to this questionnaire is to the best of my knowledge and belief, true, correct and complete.

_____	_____	_____
Date	Signature of Corporate Officer, Partner or Owner	Title

OR:

I declare that, although I am not an officer of the corporation, I have prepared this report upon the basis of all information of which I have knowledge.

_____	_____	_____
Date	Signature	Title

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UNITARY DETERMINATION
Revised July, 2016

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I. PURPOSE

In order to support a determination that companies are engaged in a unitary relationship, the auditor will need to gather documentary evidence. The determination of whether or not a group of companies are involved in unitary business activities is one of the most time-consuming and difficult parts of an audit. The purpose of this chapter is to assist the auditor in making the determination of whether a unitary relationship is present between companies by defining and clarifying what comprises a unitary relationship and to help identify the evidence needed to support this conclusion. However, all companies are not involved in unitary business operations.

Note: To aid referencing, hyperlinks are used within the body of the chapter to link to referenced exhibits and text.

II. REFERENCES

A. ILLINOIS INCOME TAX ACT

- IITA § 304 (a), (f)
- IITA § 305(a)
- IITA § 913
- IITA § 1501(a)(18)
- IITA § 1501(a)(27)

B. ILLINOIS ADMINISTRATIVE CODE

- 86 IAC § 100.3320(c)
- 86 IAC § 100.3350
- 86 IAC § 100.3360
- 86 IAC § 100.3380
- 86 IAC § 100.3390
- 86 IAC § 100.9530
- 86 IAC § 100.9700
- 86 IAC Part 200

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C. INTERNAL REVENUE CODE (IRC)

- IRC § 267 (b)(2)
- IRC § 318(a).

D. COURT CASES

- John Deere Plow Company v. Franchise Tax Board, 38 Cal.2d 214, 238 P.2d 569 (1951)
- Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983)
- Caterpillar Tractor Co. v. Lenckos (1981), 84 Ill. 2d 102
- The Dow Chemical Co. v. Glen Bower, Cook County Circuit Court, No. 01 L 50340 (2003)
- Shell Oil Company vs. Iowa Department of Revenue, 488 U.S. 19 (1988)

See the Exhibits section for more a comprehensive listing of related unitary cases, and chapter 49.

III. IITA Definition OF A Unitary Business Group

The definition of a Unitary business group (UBG) is in Illinois Income Tax Act (IITA) § 1501(a)(27). A UBG is a group of persons related through common ownership whose business activities are integrated with, dependent upon, and contribute to each other.

Key points of IITA § 1501(a)(27) are:

a) Members of a UBG must be related through common ownership.

b) The business activities of the members must be integrated with, dependent upon and contribute to each other.

c) Unitary business activity will ordinarily be illustrated where the activities of the members are in the same line of business or steps in a vertically structured business or enterprise, and in either instance, the members are functionally integrated through the exercise of strong centralized management.

d) UBG's cannot include any member whose business activity outside the United States is 80% or more of the member's total business activity (an"80/20 company").

e) UBGs cannot be comprised of members who are ordinarily required to apportion income under different subsections of IITA § 304. See Audit Manual Chapter 27.

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IITA §1501(a)(27) indicates common ownership as the first requirement for a group of affiliated businesses to be considered as unitary in nature. Corporations must be more than 50% owned by the parent company to meet this test. Secondly, the members will usually be in the same general line of activities or be horizontally or vertically structured. Third, the members will usually be functionally integrated through the exercise of strong centralized management.

IV. DEVELOPING THE UNITARY DETERMINATION

A. IDENTIFYING THE COMPANIES INVOLVED

Gathering information to support the contention that either a unitary business relationship exists or does not exist is a very complex task. The first step in developing a unitary determination is to identify the companies involved, their business activities and relationships. The auditor should prepare a worksheet for the initial process of identifying companies and provide an overview of the types of unitary groupings which may be possible. Information that could be included in the worksheet is:

- Identify the companies by name and FEIN
- Was this company in existence during the audit period?
- Who owns or controls the voting stock of each company and in what percentage?
- Is this company considered to be a standard 3-factor company under IITA § 304(a) or must it use one of Section 304's special apportionment formulas?
- Is this an 80/20 company?
- What is the general business activity of the company (manufacturing, retailing, service, etc.)?
- Any other comments regarding the type of company, its product lines, its relationships with other affiliated companies being examined.

B. SUPPORT FOR THE UNITARY DETERMINATION

Where the evidence to support a unitary definition is found is dependent upon the case at hand. The following guidelines are a SAMPLE of the type of information needed and some possible sources of this information. It is not intended to be a mandatory directive for every case, nor is it meant to be an exhaustive list of guidelines in determining whether a unitary business group exists. Instead, it should be used as a tool in the development of a factual unitary determination. It will be necessary to assess the relative importance of each of the unitary criteria in each audit.

Many facts regarding the general structure of the business entities, their operations during the current year, their future plans and goals, and their interaction with affiliates can be found in such general sources as the Annual Report to the Stockholders, the 10-

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K Report, the Federal returns, informational publications (such as Mergent Online and Standard and Poor's), magazine articles, etc. Any information obtained from these sources must be examined bearing the purpose of the report or return in mind. For instance, the Annual Report is written by the company to inform the stockholders of the operations, performances and goals of their company. It is also used to sell the company to potential investors. The reliability of the information about the companies must be weighed by this fact.

Information involving some of the internal aspects of the companies can be found in the following:

1. Corporate minutes of the Board of Directors meetings. These minutes can provide background information relating to corporate acquisitions, expansions, personnel transfers, etc. The amount of control exercised by this group of directors over the affiliated group can sometimes be substantiated by reports presented at these meetings.

2. Operating manuals. These manuals often discuss the internal controls and reporting requirements of the organization and may be used to confirm or contradict oral statements made by the taxpayer.

3. Procedures and forms manuals. These manuals might indicate various types of reports that are available, to the extent procedures and forms are standardized throughout the organization. This could provide other sources of information for establishing the existence, or nonexistence, of a unitary business relationship.

   When dealing with any type of manual it is very important to determine the date that the policies, procedures, etc. were put into effect or revised. Make sure to examine the version of the policy or procedure that was being used DURING THE AUDIT PERIOD.

4. Organizational flow charts present graphically a picture of the overall operation. Many of these charts show the chain-of-command or reporting lines and should be obtained.

5. Interviews with corporate personnel. Generally it is wiser to gather as much information regarding the companies, their operations and their relationships as possible before interviewing corporate personnel. These interviews can provide a large amount of information regarding the internal aspects of the corporations. However, their primary importance is to verify documented information or to provide additional sources of information to be examined.
   It is important to interview people who are knowledgeable in the area being discussed. The auditor's primary contact will usually be with the treasurer, director of taxes, tax manager of state and local taxes, controller, or an

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independent certified public accountant (after obtaining an executed Power-of-Attorney). Their knowledge of the operations might be only general in nature and concerned mainly with record keeping. Answers to questions on specific issues should, therefore, be obtained by contacting individuals with primary responsibility, such as vice-president in charge of sales, an inventory control or distribution director, or someone in charge of payroll and withholding in the account department. Appointments to meet and interview these individuals should be made through proper channels.

6. Internal correspondence and memoranda. The auditor may want to review the general correspondence file of each principal officer. Data contained in the file is generally helpful in establishing unity. Discussions with the officer or secretary should disclose the type of file maintained and its availability. Because of its sensitive nature, good judgment should be used when requesting this data.

   Examination of telephone bills and telex messages may also be useful to determine the frequency of contact between entities and help to show control or dependence when attempting to establish unity.

   Usually, only key personnel use company aircraft. The log might be used to establish management and supervisory control when attempting to show dependency and unity between locations and entities.

7. Internal audit reports and recommendations, responses to such reports and follow-up action. These reports, follow-ups, etc. can provide insight into the company's internal policies and procedures and the amount of control one company or division has on other companies or divisions within the group.

The first specific step to take in determining a unitary business group involves establishing what companies are involved, the relationship of the companies, their business activities, and their corporate structures. The companies meeting the common ownership requirement should be identified. Some information which should be documented in the unitary determination relating to these areas follow. REF: MTC Corporate Income Tax Audit Procedure Guideline Manual, MTC Index 2104.

1. Documentation and Evidence

   Proper documentation is vital in the preparation of all unitary determinations. Simple statements such as "There are intercompany sales." are not adequate to support a conclusion that the companies are involved in unitary business operations. The field supervisor, Technical Review, or Administrative Hearings will return audits if the audit issue(s) are not fully developed. In addition to providing evidence to support the auditor's conclusions, information discovered during the audit (or provided by the taxpayer) that supports the taxpayer's

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position should also be included. It is important to show that in arriving at the audit conclusions, all of the available facts were considered and not just those that supported the auditor's position. In this way the taxpayer's position and supporting documentation can be addressed and rebutted by the auditor and/or Legal Services before the hearing or court proceedings.

The details in arriving at the audit conclusions should discuss why taxpayer family members qualify or don't qualify within the context of IITA 1501(a)(27) (plus any other applicable authorities). It is not sufficient to state that the taxpayer is unitary because they were unitary during the last cycle. Neither is it sufficient to state that a taxpayer is unitary because they filed that way voluntarily. During each audit, we should confirm the taxpayer's unitary grouping, expanding or limiting the scope on a case by case basis. The rationale that we rely on to confirm (or deny) the taxpayer's position should be the same rationale used in our audit comments. Auditor comments must have sufficient detail supporting the rationale behind the unitary position.

Many audits have been lost at the appeal level because the auditor failed to properly document the facts in the audit. Facts stated in an audit narrative which are not properly documented can be simply denied later by a taxpayer. It is important to remember that it can take years from the time an audit is completed until the audit reaches the hearing stage. During that time the auditor who performed the audit may no longer work for the Department or will have forgotten where the information was obtained. Without proper documentation and evidence the Department's case is seriously jeopardized.

A great deal of judgment must be used in determining when to thoroughly document an issue in the audit. As a general rule, the facts of an audit should be thoroughly documented if there is a strong possibility that the issue or issues will be appealed and are significant. THIS DOES NOT MEAN HOWEVER THAT NO DOCUMENTATION IS NEEDED ON AGREED OR PAID CASES. The auditor must provide some documentation so that the audit can be reviewed by the audit supervisor and by Technical Review. Also, it is difficult to uphold adjustments where the auditor provided minimal documentation believing the adjustments were agreed only to have the tax manager or outside representative decide to disagree at the end of the audit. This could be the result of a deliberate attempt by the tax manager to mislead the auditor or the tax manager could be overruled by higher authorities within the corporation or outside counsel retained by the corporation. Finally, the tax manager could also agree and pay the audit only to file a claim for credit at a later date protesting the audit adjustments.

If a taxpayer refuses to provide requested information, formal document request procedures should be initiated as discussed in the following paragraph. However, if the information is never obtained at the field level, it is still important to identify

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the information source documents and/or the persons responsible for those documents in the audit file. If the results of the audit are protested and the matter goes before the Illinois Tax Tribunal or the Administrative Hearing Section, the Department can formally request the information through Discovery.

Further information regarding the discovery and hearing process may be found in 86 IAC Part 200: Practice and Procedure For Hearings Before the IDOR.

a) Documenting Requests For Information

All requests for information need to be supported by a form of written documentation. Using the form EDC-5, write up all verbal contacts and what information was discussed. Any information that was verbally requested and received should be indicated on the EDC-5. Additionally, a confirmation e-mail should be created and shared with the taxpayer detailing what was discussed during any meetings between the auditor and the taxpayer. This e-mail should be referenced on the EDC-5.

The EDC-5 will act as a log for the auditor and to verify the extent of taxpayer compliance. All requests for information should be in writing. In the event of non-compliance a second or third request **must** be asked for in writing. The EDC-5 may be accessed on the auditor's computer under Standardized Forms, Audit Forms, and then select EDC-5.

The Department Form EDA-70 is provided with the sole purpose of documenting requests for records from the taxpayer. The EDA-70 can be accessed on the Department's Intranet under: Work Areas, Audit, and then Forms. See Audit Manual Chapter 20 for more information on the EDC-5 and EDA-70.

The general requirement for what constitutes the minimum books and records required to be kept by a person may be found in 86 IAC §100.9530. 86 IAC § 100.9530(a)(2) provides that the books and records shall be kept at all times available for inspection by the Department, its agents and employees. In situations where information has been requested from the taxpayer, and the taxpayer is refusing to provide the information requested, the Department can and will issue a subpoena to obtain the records. However, to enforce a subpoena the Department must be able to show that:

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- The records requested are relevant to the inquiry;
- The request is reasonable;
- The taxpayer is the sole possessor of the records requested; and,
- A demand for the records was made by the Department and the taxpayer refused to provide the records requested.

In addition to using the EDA-70, we should implement the use of a formal unitary questionnaire. The Information and Document Request For Affiliated Companies, or EDA-132 should be used to obtain information related to affiliated companies. It may be issued in addition to any request for documents the auditor requires. A copy of the Form EDA-132 is located in the historical extracts and exhibits section for reference purposes and in the CIT standalone file on the auditor's computer.

b) Documenting Information Reviewed In the Audit

During the course of the audit, material may be examined that is not photocopied and included in the audit file due to volume or the nature of the information. Usually under these circumstances, notes about such material should be made and included in the audit.

Refer to audit manual chapter 20 for a further discussion of the Department's position and the procedures to follow in situations in which a taxpayer refuses to allow information to be photocopied during an audit.

It is not necessary for an auditor to restate information in his narrative report if the same information is located in the audit work papers or the audit exhibits. For example, if intercompany sales between corporations have been properly documented, the work papers should contain a schedule showing the dollar amount of sales between corporations by year. A brief summary in the narrative of the intercompany sales with reference to the specific page of the work papers is all the information that is necessary. This approach is similar to treating the audit narrative as a table of contents directing you to where the referenced support is in your documentation.

The most important thing to remember when developing the support for a unitary determination report is that, if the case is un-agreed, the protest proceedings may not take place for years after the audit has been completed. The State's position and case will be based on information that is obtained from the auditor and contained in the audit file. Therefore, it is imperative that as much information as can possibly be gathered be

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included, documented and explained in the audit file so that the audit conclusions are adequately supported.

C. CORPORATE OWNERSHIP STRUCTURE

List each affiliate, year incorporated, date acquired (if an already existing business), and the percentage of stock owned. Identify any other affiliate or parent which owns any portion of its stock. If it is a complex second or third tiered ownership situation, an ownership chart may be a useful tool.

D. PARENT OPERATIONAL STRUCTURE

Describe the functions of EACH of the parent's operating divisions. Indicate the location of each manufacturing or other type of operational facility included in each division, the specific products made or otherwise processed at each plant or facility and/or the regular services rendered by each division; the names and positions of the key officials of each division and the city where each is headquartered. Whenever possible, obtain charts showing these divisions and any subunits and the reporting lines of authority.

E. SUBSIDIARY OPERATIONAL STRUCTURE

For EACH subsidiary describe where it is headquartered, where its manufacturing or other operating facilities are located, the specific products manufactured, processed or distributed at each facility and/or the regular services rendered at each location. Name its principal OPERATING officials and at what location the services are performed. Explain to what extent, if any, each subsidiary reports to and is under the operational control of the parent or of another affiliate.

The above information will essentially establish common ownership between the companies and which companies are involved in the same line of business or are steps in a vertically structured enterprise. The next step in determining a unitary business group involves the functional integration criteria. A portion of the following information is also based on procedures contained in the MTC Corporate Income Tax Audit Procedure Guideline Manual, MTC Index 2104.

F. COMMON OFFICERS AND DIRECTORS

For the PARENT corporation:

1. For each audit year, list the names and positions of all corporate officers through the assistant or vice levels (e.g., all vice-presidents, assistant secretaries and treasurers, etc.). Indicate the city where the corporation is headquartered, and

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list the city where the office of each of these officials is located (some may not regularly serve at the corporate headquarters).

2. For each audit year, list the names of each director, and indicate who are chairman and vice-chairman. Indicate which are officers of the parent and the position held there. For those board members who are NOT officers of the parent, indicate which officers are officers of any affiliate; name the affiliate and the position held there.

The same information should be obtained for each affiliate as is described above for the parent. If there is a large group of affiliates, then this information should be limited to all principal affiliates.

This is ESSENTIAL information. It avoids the frequent prior practice of stating only that "there are common officers or directors" without further identification of the names and at what position levels, which is an incomplete and useless generalization. The by-year coverage will be useful in showing any officer changes during the entire audit period.

G. PARENT/SUBSIDIARY MANAGEMENT STRUCTURE

1. Obtain a complete description of the parent's organizational structure showing the chain of command and reporting lines from the president and/or chief executive officer down the organization, including its divisions. A chart or charts to illustrate this should be obtained, if possible.

2. Obtain a complete description of the regular reporting procedures and requirements of all of the principal domestic affiliates to the parent on such items as:

   a) Current sales
   b) Current profit or loss statements
   c) Annual budget
   d) Requests for new or expanded production and distribution facilities
   e) Any other miscellaneous periodic reports

Identify each category of required report and indicate whether it moves through a particular division of the parent or directly to the parent's headquarters and, if so, to what official or unit at the parent's headquarters.

3. Obtain a complete description of the functions and responsibilities of each of the officers at the parent's headquarters regarding BOTH the parent's operations and the operations of any of the subsidiaries. Job descriptions of the officers and/or managers are an excellent source of information. Also interviews with the

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appropriate personnel in the organization may provide some information regarding the duties and responsibilities of key positions.

4. Obtain a complete description of the organization of the parent's Board of Directors, indicating to what extent it has committees such as Finance Committee, Budget Committee, Executive Committee, etc., and name the members of each committee. There may be a chart available showing this organization. Describe the duties and authority of EACH committee (and/or of the board as a whole) as they relate to budgets, acquisitions, financing, new or expanded facilities, salaries, of principal officers, etc., BOTH for the parent itself and any of the subsidiaries.

5. Does the Board of Directors of each subsidiary corporation report to the Board of the parent corporation?

6. Do officers or directors of the parent and subsidiary corporation meet in common committees?

7. Do any of the parent corporation's committees plan for or monitor the subsidiary corporations?

8. Does the parent corporation establish goals or formulate policy for the subsidiary corporations?

9. Does the Board of Directors of the parent corporation control the amount and/or distribution of any dividends paid by the subsidiary corporations?

10. If the subsidiary corporation pays dividends to the parent corporation, are these funds segregated from general funds of the parent corporation?

11. Does the subsidiary pay any management fees to the parent corporation or another affiliate? If so, for what services, property, etc.?

12. Does the board of directors of the parent corporation approve major expenditures of the subsidiary corporation (e.g., capital purchases, expansions, etc.)?

13. Does the parent corporation approve or sign contracts for the subsidiary corporation? If so;

    a) Are these contracts signed at the parent corporation's headquarters?

    b) Are countersignatures by the parent corporation necessary on any of the subsidiaries' contracts?

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c) Are countersignatures by the subsidiary corporation necessary on any of the subsidiaries' contracts signed by the parent corporation?

14. Are portions of the parent corporation's centralized overhead costs distributed to the subsidiary corporation for accounting purposes? If so, what type of overhead expense is distributed?

15. Are there any common terms of sale or sales contracts used by the parent corporation and the subsidiary corporation?

H. INTERCOMPANY SALES/PURCHASES

Sales may be made from parent to subsidiary, from subsidiary to parent, from subsidiary to subsidiary or by all of these methods. Summary schedules which lump subsidiaries as a group without further breakdown are not helpful in determining the extent of possible unitary activities of any particular subsidiary. As discussed previously in the “Functional Integration” section, the amount of intercompany sales or purchases made is not always the major factor. The type of product being sold or purchased and its availability from other sources are also important factors.

The following information should be included (for each audit year) in the unitary determination report, to support a conclusion that intercompany sales exist.

1. For the parent, regarding its sales TO subsidiaries:

   a) Total intercompany sales.
   b) The name of EACH subsidiary to whom it made sales.
   c) The separate amount of sales to each such subsidiary.
   d) Total sales to all buyers.

If the parent produces several different types of products, indicate also the general category or categories of products involved in these sales.

2. For the parent, regarding its purchases FROM subsidiaries:

   a) The name of each selling subsidiary.
   b) The separate amount and type of products purchased from it.
   c) The amount of the parent's total purchases from all sources.

3. For each subsidiary making intercompany PURCHASES:

   a) The separate amount and type of product purchased from EACH affiliate.
   b) The total amount of the purchasing corporation's purchases from all sources.

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4. For each subsidiary making intercompany SALES:

    a) The name of the affiliate.
    b) The separate amount and type of product sold to it.
    c) The selling subsidiary's total sales to all buyers.

Obtain copies of any agreements between the affiliates regarding intercompany sales, and review the agreements for evidence of an integrated business. For example, “requirements” and “output” provisions (which require the purchaser to buy only from the seller or require the seller to sell all of its output to the purchaser) or provisions requiring one or both parties to deal first with the other party are indications that the businesses are integrated. Also, failure to enforce the terms of a contract is evidence that the parties are sharing value between them, because otherwise each party would insist on receiving the benefit of its bargain. If possible, obtain information regarding the price and other terms at which intercompany sales are made and the price and other terms at which sales or purchases of the identical items are made with unrelated parties.

I. COMMON MARKETING

Common marketing can be a very important factor in determining the existence of a unitary business. In order to be noticed in a highly competitive market, products are likely to be nationally and locally advertised through the use of newspapers, general magazines, trade publications, radio, television or a combination of any of these methods. The answers to the following questions can help support a conclusion that common marketing exists:

1. To what extent does the parent operate an advertising division or department? What specific activities does it conduct for each principal category of products? How many people does it regularly employ for these activities? Which principal subsidiaries receive the benefits or utilize the advertising produced by the parent? To what extent are they charged for this central advertising activity and how are the charges determined? Which principal subsidiaries either independently produce their own advertising or do NOT use any of the centrally produced advertising materials? If possible, obtain the annual advertising costs of the parent for each audit year.

2. Do the parent and/or any of the subsidiaries advertise any of their products under a common brand name, company, symbol, logo or trademark?

3. Does a common or similar brand name, symbol, logo or trademark appear on stationary or other documents of the parent and/or any of the subsidiaries? Is there an “intangible holding company” that owns all the trademarks and trade names of the affiliates? Which affiliates pay a royalty for use of these

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intangibles, and what were the terms of transfer of the intangibles from the affiliates to the holding company? Obtain copies of any royalty agreements or agreements regarding transfers of intangibles to the holding company. Also, determine if the holding company itself incurs the costs of registering and protecting the intangibles, or if the costs are incurred by other members of the group.

4. Do the parent and/or any of the subsidiaries engage in any common promotional activities of their products or services?

5. Does the parent or an affiliate advertise for any of the subsidiaries?

6. Does the parent or an affiliate pay for the advertising of any of the other subsidiaries?

7. Is the advertising of the parent and/or any of the subsidiaries handled by the same agency?

   Note: As discussed in the "Functional Integration" section above, the common use of an advertising agency is not, in itself, a major unitizing factor. It can, however, help to support a general common marketing characteristic of a group of companies.

8. Are there common customers or types of customers (e.g. retail stores, doctors, etc.) for any of the companies?

9. Do the subsidiaries make a reference to their parent in their advertising (i.e., ABC Corporation, a subsidiary of XYZ Corporation)?

10. Is there a common sales staff for the parent and/or any of the subsidiaries? Do salesmen routinely refer products produced by affiliates to their customers? Is there a common service or repair division for the products?

J. TRANSFER OR POOLING OF TECHNICAL INFORMATION

The transfer of technical information is another major factor in the determination of a unitary business group. Technical information can be in the form of patents, copyrights, general research and development facilities, and technical personnel. The following areas should be developed to support a conclusion that a sharing of technical information exists between a group of companies. One of the primary sources of the following information is the technical assistance agreements, which are in effect between the various companies.

1. For any royalties received by the parent, for each audit year:

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a) Identify the total amount received from all sources
b) The total amount received from all affiliates
c) The SPECIFIC amount received from EACH AFFILIATE

Also include a description of the particular type or types of rights controlled by the parent, which were exchanged for its right to receive these royalty payments from EACH AFFILIATE. If a patent originated with another affiliate, on what terms was the patent transferred to the parent? If a patent is also licensed to outsiders, how do the terms of licenses to affiliates compare with the terms of licenses with outsiders? Who incurs the costs of registering and protecting patent rights?

2. For any royalty payments received by a subsidiary either from the parent or some other affiliate, the same detailed information as indicated for the parent above should be provided.

3. Identify all situations where a manufacturing plant of the parent and a manufacturing plant of a subsidiary produce identical or similar products. To what extent in this situation are patents, processes, and trademarks furnished by the parent (or vice versa)? Are royalty payments paid for their use and to what extent?

4. Identify the location of each research facility of the parent, the scope of the facilities, the number of personnel at each, and the specific types of research conducted at each.

5. Provide the same data as above for each research facility maintained by a subsidiary.

6. Explain in specific detail to what extent, if any, there is coordination, exchange of data, associated programs, and any other links between a research facility of the parent and a research facility of a subsidiary (or between facilities of two subsidiaries). Is joint research conducted between the facilities of the parent and any subsidiary or between facilities of two subsidiaries?

7. Do the parent corporation and/or any of the subsidiaries use any common research and development data, or engineering or planning data?

8. Does the parent corporation conduct research for any of the subsidiaries? Do any of the subsidiaries conduct research for the parent or other subsidiaries?

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9. Are there any common research personnel or are there any intercompany transfers of this type of personnel during the audit period? Identify, if applicable, the personnel, the function, their qualifications and the reason for the transfer.

10. Identify all principal or brand name products sold during the audit years by subsidiary which are directly traceable to and/or result from research projects at the parent in current or prior years.

Information about the results of research projects is often found in Annual Reports for current and prior years and is usually available when the corporate group deals in such items as drugs, cosmetics, household appliances, toiletries, nonprescription medicines, or other types of mass production consumer products where new or improved products are periodically put on the market.

K. COMMON DISTRIBUTION SYSTEM

The following type of information can usually be found by examining financial statements, property leases, Mergent Online, Standard and Poor's, and any other reports involving the ownership, lease, or use of property.

1. Does the parent and/or subsidiaries share any of the following:

    a) Sales facilities
    b) Storage facilities
    c) Transportation operations
    d) Inventory control operations
    e) Sales accounting operations
    f) Communication systems

2. Are there any written lease contracts between the companies for any of the above?

3. Are there any intercompany management fees paid for the types of facilities or services listed above?

L. COMMON PURCHASING

Common purchasing is also a factor of major importance in determining a unitary group. The following areas should be examined to establish a common purchasing function.

1. Describe any central purchasing activities of the parent such as:

    a) Specific categories of purchases.
    b) Which principal subsidiaries receive the benefits of such activities?
    c) Which principal subsidiaries are NOT involved in such activities?

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Try to obtain the amounts of such purchases for each audit year to determine whether the activities are significant or relatively minor.

2. Does the parent purchase raw materials for any of the subsidiaries?

3. Does the parent or affiliate purchase office supplies or equipment for any of the subsidiaries?

4. Does the parent make the decision or approve any major purchase contracts of any of the subsidiaries?

5. Are there volume benefits received by the parent as a result of purchasing for the subsidiaries?

6. Are there common suppliers from whom goods or equipment are purchased?

M. INTERCOMPANY FINANCING

Intercompany financing may be a significant unitizing factor if the purpose of the financing is for business expansion, day-to-day operations, or the functional integration of the business segments. In common terms this type of intercompany financing is known as a cash management system. If the purpose for the financing is simply to protect an investment of the parent or subsidiary, it becomes less important.

Also, any intercompany financing is evidence of sharing of value between members, because it is generally true that the interest rate will not reflect the market rate for one of the parties-either the borrower would not have been able to obtain that rate from an unrelated lender or the lender would not have been able to obtain the same rate on an identical loan to an unrelated party. However, interest rates and other terms of intercompany loans, and the enforcement of those terms that clearly do not reflect the market are even stronger evidence of the sharing of value that creates a unitary group. Some information which should be gathered to support an intercompany financing/cash management system conclusion follows:

1. Identify loans from the parent to subsidiaries existing at the beginning of the audit period. Show separate amounts for each borrowing subsidiary and find out the specific purpose for each substantial loan and whether it is interest bearing. An audit source may be the intercompany elimination on consolidation. Note whether the terms of the loan being enforced in the same manner as they would be enforced between unrelated parties. For example, are payments actually being made, and made on a timely basis? Is a loan extended beyond its term, when market conditions have changed so that an unrelated party would have terminated the loan or renewed it on different terms?

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2. Explain the extent of any repayments made on each loan identified above during each audit year.

3. Identify all new loans, and their amounts, made by the parent during each audit year separately for each borrowing subsidiary. Indicate the purpose of the loan and whether it is interest bearing. Is the loan made at the current commercial rate of interest?

4. Identify any loans made during each audit year by:

    a) Loaning affiliate.
    b) Borrowing affiliate.
    c) Purpose of the loan.
    d) If it is interest bearing and if so, is the loan made at the current commercial rate of interest?

5. Obtain data showing to what extent, if any, the parent corporation was a GUARANTOR of any loan obtained by a subsidiary during the audit period or which was still outstanding during that period. Identify the year when each loan was made, its amount, the name of the borrowing subsidiary and the purpose of each loan.

6. Identify for each subsidiary the amount of loans (for each audit year) that it independently obtained from outside sources and on which the parent was NOT a guarantor.

7. Review the consolidating workpapers for information regarding intercompany elimination of loans payable and receivable. If this analysis is not available, the loan file is an alternate source to obtain the data.

8. If any of the subsidiaries need to borrow funds, are they REQUIRED to borrow only from the parent or another subsidiary? Are they required to use the parent or another subsidiary as a first source for the needed funding?

9. Do any of the subsidiaries borrow from outside sources based upon the financial strength of the parent or the affiliated group as a whole?

10. Do the parent and/or any of the subsidiaries utilize common banking facilities?

11. Does the parent negotiate loans or obtain capital for any of the subsidiaries?

12. Does the parent approve loans for any of the subsidiaries?

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13. Do the parent and/or any of the subsidiaries loan or advance money to each other, either by direct loans or intercompany assignments of accounts receivable? If so, are there written agreements regarding these loans or advances? Are the loans or advances made with interest rates set by the parent?

14. Do the parent and/or any of the subsidiaries borrow from common financial institutions?

V. DETERMINING THE DESIGNATED AGENT

In order to process any unitary return or audit, a designated agent (DA) should be selected by the taxpayer. Both 86 IAC §100.5220(a) and the Schedule UB Instructions provide the guidance on who should be the DA for members of a UBG. The DA must be:

- a member of the UBG and an Illinois taxpayer
- if the controlling corporation is a member of the group and an Illinois taxpayer, it **must** be the DA.

If the controlling corporation is not an eligible member of the group, the members must choose another DA. Ideally, the Illinois filing member with the largest consistent liability **should** be selected.

There are instances of when a controlling corporation will not be a member of the combined group, when:

- the combined group is combined of corporations that are wholly owned by an individual. (no controlling corporation);
- the owning corporation and members are required to use different apportionment formulas (e.g. IITA § 304(a) and IITA § 304(c)); or,
- the controlling corporation does not have Illinois nexus.

Once a designated agent is appointed for the group, it should remain the DA for all future periods unless the DA ceases to be a member of the group; the controlling member becomes eligible, or is replaced by an eligible member. During audit it may be determined that a change in the DA is required. If a change in DA is required, the auditor must obtain a statement from the group authorizing the change of DA. This statement must accompany the auditor's workpapers in order to: combine tracks, correct Gentax information, merge groups, and inform audit areas (planning, technical review, audit perfection) to merge dual or multiple designated agents.

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Note: **The Change of Designated Agent Form (IDR-229-UB, see Sub section c below)** should be submitted at the **beginning** of the audit in order to inform Technical Review and Audit Perfection of the change in DA(s) so that they can prepare the proper adjustment documents to transfer the returns, set up additional tracks and audits and/or cancel tracks and audits.

A. WHEN TO CHANGE THE DESIGNATED AGENT

1. If the controlling corporation was an eligible (Illinois nexus) member, but did not file as the designated agent, then the IDR-229-UB should be completed. An EDA-25 should be prepared on a combined basis with the payments and return information from all the other eligible members transferred to the designated agent's FEIN. The IL-870 should show which companies are being combined, so the information can be transferred by Audit Perfection.

   - ✓ The auditor must inform the taxpayer that the unitary members are required to file under the controlling corporation for future years.

2. If the controlling corporation (or the chosen designated agent) was not an eligible (no Illinois-nexus) member, but filed as the designated agent, then a new DA must be chosen by the group. The entire group must consent to the appointment of the new designated agent. Therefore, the auditor **must** obtain the signed change in designated agent form to make the correction.

   - ✓ The new designated agent's number is to be used on all audit documents.

3. Two or more unitary groups are being combined into a single large group by the audit. If the following criteria are met, only the signatures of the old designated agent(s) and the new designated agent are needed to appoint the proper designated agent for the new group:

   i. The taxpayers agreed to the unitary group change.

   ii. The designated agents for each of the old groups met the requirements of the Regulations. (The agent was the controlling corporation (if eligible), or another eligible member (if the controlling corporation was ineligible)).

   iii. The designated agent for the new group was a designated agent for one of the old groups).

4. The taxpayer files an IL-1120-X combined Amended Return to change the

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designated agent or to change the members of the group. Once a taxpayer has filed an amended return to make the changes to the group, amended returns must be used rather than EDA-25's to make the group corrections. The old designated agent must zero out its return and state that it is changing the designated agent. Eligible members that are being added to the combined group must file separate amended returns showing no net income, overpayment or underpayment. They must state that they are joining in the filing of the combined amended return. Ineligible members that are being removed from the group must file a separate amended return for their own filing. (REF: 86 IAC §100.5260).

B. DESIGNATED AGENT FUNCTIONS AND RESPONSIBILITIES

While the requirements of who can be DA are specified in 86 IAC §100.5220(a), 86 IAC § 100.5270 specifies the DA's responsibilities. The DA is responsible for computing the combined net income and tax of the group. The DA will compute the combined group's current year combined taxable income, or combined Illinois net loss if the groups combined taxable income is less than zero. The DA is responsible for applying any modifications to the amount of combined net income by correctly determining the combined groups combined Illinois addition and subtraction modification amounts.

Certain Illinois items that the DA is responsible for including:

- Carrybacks or carryovers will be determined for individual members of the group and a pro rata share of the loss is attributable to each of the loss members. The application of 86 IAC §§ 100.2250(c)(3) and (4) provides the determination for carrybacks and carryovers.

- NOL addition modifications as provided for in 86 IAC § 100.2340, and 86 IAC §§ 100.2350(c)(3) and (4).

- Combined nonbusiness and nonunitary partnership income allocable to Illinois.

- Combined Illinois net loss deduction (NLD), the DA will compute the NLD by determining the amount available for each member of the group as provided for by 86 IAC §§ 100.2330, 100.2340 and 100.2350.

- Combined credits allowed by the IITA will be based on the combined activities of the members of the combined group. Credits will be applied against the combined liability of the combined group. See chapter 36 section on "Unitary Group Filing Combined IL Returns" for an expanded discussion of credits.

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1. Common Taxable Year

When members of a UBG have different accounting periods, it is necessary to compute unitary business income and the apportionment formulas of all group members using a common accounting period. 86 IAC §100.5265(a) provides that the taxable year of the designated agent of the group is to be used as the common taxable year (CTY) for years ending after December 31, 1998. The combined group must thereafter use the taxable year of the designated agent.

For taxable years ending prior to1998 the regulations allowed the use of the parent's accounting period and considered this as the CTY. If there was no common parent, the accounting period of the Illinois filing member who is expected to have, on a recurring basis, the largest Illinois tax liability could be generally used. However, this portion of the regulation was repealed August 23, 2002.

Once a CTY is determined, members with a different taxable year must adjust their income and factors to reflect their activities for the common taxable year. 86 IAC §100.5265(b) provides three methods which are allowable for the combined group to adjust a members' taxable year:

1. Pro-forma taxable income from books and records for the CTY, where the taxable year is calculated using a number-of-months method obtained from the original accounting periods.

2. Pro-rated shares of its taxable income beginning and ending in a CTY, as this may be used when the member's taxable year begins after the beginning of the combined common taxable year, and ends after the common taxable year.

3. Separate company taxable income of the member, for any taxable year ending in the CTY is to be included in the combined net income of the combined group.

86 IAC §100.5265(b) provides two examples for the second method; the first example is restated here:

Example:
Corporation A is a calendar-year member of a combined group having a common taxable year ending July 31. If Corporation A uses the method described in this subsection (b)(2), its taxable income for the taxable year ending July 31, 2005 would be five-twelfths of its 2004 taxable income and

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seven-twelfths of its 2005 taxable income. Rather than using months to pro-rate its income, Corporation A may use the number of days in its taxable year or (in the case of a corporation using a 52/53 week taxable year) the number of weeks in the taxable year. The combined return for the common taxable year ending July 31, 2005, may not be filed until after December 31, 2005, the close of Corporation A's taxable year which begins during that common taxable year.

a) Consistency of Method

Each taxpayer whose taxable year differs from the CTY may separately elect which of these three methods it will use for its first combined return. Once a member has used a particular method it will be required to continue to use the same method on subsequent returns for consistency in use. A change in method will be allowed when the change in method is disclosed in an attachment to the first return for which period the change is effective. The attachment must show:

- each year in which the member changing its method has been in the combined group, including the change year,
- the net income of the group under the former method,
- the net income of the group under the new method, and
- the totals computed using each method,
- If the net income computed under the new method in prior years exceeds the net income computed using the old method, the excess is added to the net income of the group in the year of method change. If the net income computed under the old method in prior years exceeds the net income computed using the new method, the excess is subtracted from the net income of the group in the year of method change. These adjustments prevent the change from excluding income or double-taxing income.

b) Change of Group's Common Taxable Year

A combined group's designated agent, or its members, may undergo change and leave the combined group, or cease doing business within Illinois. This may cause a change to the CTY. If the taxable common year of the combined group is changed, with its year ending prior to the year end it had been using:

- All separate company items of each member of the combined group (which occurred after the end of the previous CYT but before

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the change) must be included in the combined return filed for the first CTY after the change.

- Any separate company item reported on a combined return of a prior common year shall be excluded from the combined return filed for the first common taxable year after the change.

If the CTY of a combined group is changed and the new CTY ends after the end of the former CTY during which the change occurs:

- The combined group must file a combined return for the period ending with the date the CTY is changed, and a short year combined return for the period beginning with that date through the end of the new CTY.

C. Members Entering and Leaving a Combined Group

If a corporation joins the group, the group's CTY accounting cycle will probably be in progress. If the new corporate member was not a member of another group previously, it will file a separate return for the period prior to joining (short year) with the period ending on the day prior to its joining the group. Regardless of which method under subsection (b) is used by a member with a taxable year other than the common taxable year, if a corporation becomes a member of the combined group after the beginning of the corporations taxable year:

- If the corporation was not part of another combined group, it would simply file a short year return for the period prior to joining the combined group. The income for the separate return will equal the amount of the corporation's income for the year that is not included in the combined return using one of the three methods previously discussed above that is chosen for determining the income included in the combined group's income for the year.

- If the joining corporation had been in another combined group prior to joining this second combined group, it must use Method 1 or Method 2 above to determine its separate income, and would report this income to the respective group(s) for the time it was in that group.

In the case of a corporation which ceases to be a member of a combined group:

- If separate income is reported to the first group, it will be excluded from being reported on a second combined return with a second group, or on a separate company return.

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D. CHANGE OF DESIGNATED AGENT FORM: IDR-229-UB

An example of the Change of Designated Agent Form is presented in the Historical Extracts and Exhibits section. The form will act as a flag to Audit Perfection. The forms layout will allow the Department to:

- Identify the old and new DA by name, FEIN and controlling company,
- Provide the contact information for the responsible officer for the schedule,
- Identify by name and FEIN the members of the UBG,
- Provide the authorization signatures of the officers confirming the change

The last section of the form is comprised of blank lines. This will allow an area to provide specific comments and instructions for the auditor to guide the Audit Perfection area to accurately process the change(s). The IDR-229-UB may be accessed by going on to the Sp-IDOR web page, selecting Work Areas, Audit, and Forms.

VI. COMMON OWNERSHIP

86 IAC §100.9700(e) provides guidance on what level of ownership is necessary to constitute a unitary level of ownership.

- In the relationship of a corporation common ownership is the ownership of more than 50% of the outstanding voting stock.

- In any other entity it is the amount of ownership at which point there is sufficient interest to exercise control over the entity. This can be either direct or indirect ownership.

For a corporation, common ownership means direct or indirect control or ownership of more than 50% of outstanding voting stock. For all other entities, common ownership means direct or indirect ownership of an interest sufficient to exercise control over the entity. An example of direct or indirect ownership regarding a non-corporate entity would be the ownership of a general partnership interest. If the partner has the authority to act on behalf of the partnership and enter binding agreements, this is considered ownership regardless of the actual ownership share. For corporations any combination of direct or indirect ownership exceeding 50% will satisfy the ownership requirement for inclusion in a UBG. However, other tests must be satisfied as well.

86 IAC § 100.9700(e) contains several examples of common ownership, one of which follows:

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Example 1
Corporation A owns 60% of the outstanding voting stock of Corporation B which in turn owns 60% of the outstanding voting stock of Corporation C. There is common ownership of Corporations A, B and C by reason of Corporation A's direct ownership of more than 50% of the outstanding voting stock of Corporation B and indirect control of more than 50% of the outstanding voting stock of Corporation C.

There are numerous supporting documents which will assist in determining whether a group of corporations meet the ownership requirement of the IITA for unitary purposes.

- Unitary Questionnaire: EDA-132 Information and Document Request for Affiliated Companies (see historical extracts and exhibits section)
- The Form 851 is filed with a federal consolidated Form 1120 to identify the parent company and affiliated members. These members are required to be at least 80% owned by the parent.
- Organization Chart
- List of Officers
- SEC 10-K reports (available from EDGAR, the SEC internet web site)
- Board of Directors minutes
- Internet Research
- CPA Auditor's Report
- Internal Audit Reports
- Operating Manuals showing degree of internal controls
- Copies of contracts showing intercompany financing
- Schedule showing common customers
- Breakdown of intercompany eliminations on the federal Form 1120

Note: The Form 851 will indicate those members of the consolidated group who are owned 80% or more and file with the parent company. The Form 851 will not provide the information for which members may be within the 50% to 80% unitary threshold. It is through the work of the audit that these members will be identified.

A. Rules Of Attribution

It is not necessary for two companies to be commonly owned by another COMPANY to be members of a UBG. The common ownership requirement may be met if an individual, a trust, estate, partnership, association, firm, Limited Liability Company (LLC) or fiduciary owns in excess of 50% of the common stock of each of the two corporations. In addition, the "person" does not have to actually be a member of the UBG for common ownership to exist. REF: IITA §1501(a)(18) and 86 IAC § 100.9700(f).

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86 IAC § 100.9700(f) further states that a person is considered having indirect control over any stock that he is considered owning under IRC § 318(a). Section 318 contains various rules of attribution of stock owned by family members to other members, between partners and partnerships, trusts and estates and their beneficiaries, and corporations and controlling shareholders.

> Note: 86 IAC § 100.9700(f) was amended effective June 30, 2008 to incorporate all of IRC § 318(a) and to apply to all persons. Previously, it applied only to individuals and used only the attribution rules in IRC § 318(a)(1), dealing with attribution of ownership between family members.

IRC § 318 (a)(1) states that an individual will be considered to own stock which is either directly or indirectly owned by a spouse (unless they are legally separated), children (adopted or blood), grandchildren or parents. An individual is not considered to own stock which is either directly or indirectly owned by siblings.

EXAMPLE 1

Mr. Smith owns 35% of Corporation A and 40% of Corporation B. His wife owns 35% of Corporation A. Each of the Smith's 3 children owns 10% of Corporation A and 20% of Corporation B. Following the federal rules, Mr. and Mrs. Smith each are considered to own (by attribution) 100% of Corporations A and B. Therefore, the common ownership requirement of IITA §1501(a)(27) has been met for Corporations A and B.

EXAMPLE 2

In 2013, Mrs. Jones owns 40% of Corporations C and D. Her son owns 30% of Corporation C. Her daughter owns 30% of Corporation D. Following the federal rules, Mrs. Jones owns (by attribution) 70% of Corporations C and D. Therefore, in 2013, the common ownership requirement of IITA §1501(a)(27) has been met for Corporations C and D.

On January 1, 2014, Mrs. Jones dies and each of her children inherits half of her holdings in each corporation. Her sons now own 50% of Corporation C and 20% of Corporation D. Her daughter now owns 50% of Corporation D and 20% of Corporation C. Based on the federal attribution rules, one sibling is not considered to own another sibling's stock holdings. Therefore, for 2014, the common ownership requirement of IITA §1501(a)(27) HAS NOT been met for Corporations C and D.

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EXAMPLE 3

A mother and her two children owned virtually all of the stock of 18 companies in similar lines of business. All of the stock of each corporation was subject to written stock purchase agreements that prohibit the transfer of stock by a shareholder to anyone other than the corporation or its other shareholders. The mother, children and son-in-law held virtually all corporate officer positions in each of the corporations. The greater than 50% ownership test was met for each of the companies because "of the mother and her children."

B. INSTANT UNITY

Some states have a set rule which states that a newly acquired corporation either can or cannot become a member of a unitary business group immediately upon the date of acquisition. Illinois has no set rule for instantly unitizing or not unitizing newly acquired corporations.

The determination of whether or not any corporation should be a member of a unitary business group will be based on the facts of the individual case. Ordinarily a corporation will NOT be unitary with an acquiring corporation immediately upon the date of acquisition because the necessary functional integration will not be present. However, it is possible that a sufficient degree of integration could be present upon acquisition (or shortly thereafter) that would support a unitary determination.

EXAMPLE

Corporation A manufactures steel rods and sells 90% of its output of steel rods to Corporation B every year. In 2010 B begins to implement a plan to purchase 100% of A's stock by December 2012. During the two year purchase period, B becomes very involved in the management and control of A. On December 10, 2011, B purchases enough of A's stock to own 51% of A and is sufficiently integrated with A that a unitary determination could be supported. A can become a member of B's unitary business group immediately on December 10, 2011.

VII. SAME LINE OF BUSINESS/VERTICAL INTEGRATION

What is the same "general" line of business? 86 IAC §100.9700(h)(3) and (4) defines what is considered to be a general line of business. This can ordinarily be illustrated where the activities of the members are in the same general line such as: manufacturing, retailing of tangible personal property, wholesaling, insurance, transportation or finance. Illinois does not distinguish between types of products to determine whether a business is in the same line. A manufacturer in theory could produce engine parts and pacifiers: manufacturing is

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manufacturing, and retailing merchandise is retailing merchandise. It is the act of retailing or manufacturing that is to be considered what the line of business activity is.

IITA § 1501(a)(27) provides that unitary business activity "can ordinarily be illustrated" where the related entities are engaged in the same general line of business or are vertically integrated. The courts in other jurisdictions have also determined that a strong indication of a unitary relationship exists when a group of companies are engaged in the same line of business or in a vertically structured enterprise.

In the Supreme Court case of *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159. (1983), the Supreme Court supported that vertically integrated companies usually constitute a unitary business. The reasoning behind this stance in treating vertically integrated companies as a unitary business is that they benefit from "an umbrella of centralized management and controlled interaction". In a vertically integrated company the interaction between the various components in the long range planning has been a focus of the court. Other areas of focus have included:

- Development of a group of company's policy and procedures
- Financing, accounting systems, personnel, legal counsel, and public relations
- Central management activities including companies engaged in oil and natural gas production, mining and mineral extraction which produce finished goods from the raw resources are prime examples of vertical integration.

When the Supreme Court reviewed the Container Corporation case, it held that when a corporation invests in a subsidiary that is in the same line of work as it is, several benefits occurred.

- Most notably, the investment makes better use of the parents existing business through economies of scale and an operational integration of shared expertise could be obtained.

A synopsis of the Container Corporation case appears in Chapter 49.

Two or more entities may also be steps in a vertically structured enterprise or process. These companies may comprise a UBG even if some of the steps in the vertical structure are performed by companies that cannot be included in the same UBG because of IITA § 1501(a)(27) limitations (80/20 companies, different apportionment formulas). Even if there is common ownership and a same general line of business, a functional integration must be present as well in order to establish a unitary basis.

If the companies that are involved in business together are in the same general line of business, this is the first step in determining that they are in a unitary relationship. It is not determinative in itself.

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- A unitary determination in audit should not be solely based upon companies being in the same line of business.

A. Discrete Business Rule

If a corporation has divisions that are involved in multiple, discrete businesses, it is necessary to determine the business income attributable to each separate trade or business. The income for each business segment is then apportioned to Illinois by an apportionment formula which takes into account the in-state or out-of-state factors for that segment of the business only. The Illinois income for each segment is then totaled to arrive at Illinois income for the company as a whole.

86 IAC § 100.3010(b)(3) provides that the determination of whether the activities of the person comprise a single trade or business, or more than one trade or business, will be on a case by case basis according to the specific facts involved. A single trade or business will be evident when the segments are integrated with, dependent upon, or contribute to each other and other operations of the person as a whole.

The following factors are considered to be good indicia of a single trade or business, and presence of any one of these factors creates a strong indication that the activities of the person constitute a single trade or business:

1. Same type of business
2. Steps in a vertical process
3. Strong centralized management

86 IAC §100.3010(b)(2) contains an example of an entity involved in three "discrete business" operations.

The discrete business rule is not considered to be a part of IITA § 304(f). There is, therefore, no requirement that a company petition the Department for permission to file its Illinois return in this manner. However, any contention that two or more separate and discrete businesses exist within a single entity is subject to approval by the Department through audit. If it is determined that the company's contention is in error, the Department will assess any additional liability through issuance of a Notice of Deficiency.

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VIII. STRONG CENTRALIZED MANAGEMENT

Functional integration of affiliates through the exercise of strong centralized management is a very common element of a unitary business group. IITA § 1501(a)(27) and 86 IAC § 100.9700(g) provide us guidance in this area. Strong centralized management is the primary indicator of: mutual dependency, contribution and integration between persons that are necessary to compose a UBG.

Strong centralized management will be deemed to exist when there is a central management authority over such matters as: purchasing, financing, tax compliance, product line, personnel, marketing, and capital investment. Individual members will defer these controls to a controlling member of the group.

When executive officers of one of the persons are normally involved in the operations of the other persons in the group and there are centralized units that perform for some or all of the persons functions that truly independent persons would perform for themselves, a group of persons could be considered as comprising a UBG under IITA § Section 1501(a)(27).

The mere existence of central management authority, or the exercise over a particular function, is not determinative of strong centralized management in itself. The entire operations of the group must be examined as a whole to determine if strong centralized management exists. Both strong central management authority and the exercising of this authority must exist in order to support a unitary finding under IITA §1501(a)(27).

IX. FUNCTIONAL INTEGRATION

If the companies under audit are found to be in the same general line of business or part of a vertically structured enterprise, they may or may not be in a unitary relationship.

- The second requirement for determining a unitary relationship is the establishment of functional integration.

86 IAC § 100.9700(g) states that no group of persons can be considered a UBG unless they are functionally integrated through the exercise of strong centralized management. This varies from the wording of IITA §1501(a)(27), which states that a unitary business “can ordinarily be illustrated” by horizontal or vertical relationship and strong centralized management. As a practical matter, however, strong centralized management exists in virtually every case where a unitary business has been found to exist. It is by this **exercise of authority** that the companies are caused to be dependent upon, contribute to or integrated with each other. It is

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not, however, necessary for the person who has the authority and is exercising that authority to be a member of the group.

86 IAC § 100.9700(g) provides that strong centralized management is deemed to exist:

- when the authority in matters like purchasing, financing, tax compliance, product line, personnel, marketing and capital investment are not left to individual members,
- when executive officers of one of the persons are normally involved in the operations of other persons, or;
- when there are centralized units which perform operations for some or all of the functions independent persons would perform for themselves.

Neither the existence of central management authority, nor the exercise of that authority over a particular function is determinative in itself. The entire operations of the group must be examined to determine a finding that centralized management exists. A finding of strong centralized management cannot solely be supported by an ownership of more than 50%, or showing that there is an incidental benefit to the group such as an improved financial position.

Under this provision, if the functions listed in the regulation are combined or centralized for the two entities, the strong centralized management test is deemed to be met, while merely showing the existence of centralized authority strong enough to run the businesses as a single operation is not sufficient. If a partnership is involved, the operations of the partner and the partnership need to be examined to verify that there are centralized functions or sharing of costs or values in the operations of the two entities. If it is shown that there is sufficient centralization or sharing, we can prove functional integration.

The mere presence of centralized management is therefore, insufficient to support a finding of functional integration. The management activities must contribute to the integration of the companies and not just fulfill normal investment stewardship responsibilities. Some centralized management activity is considered to be consistent with the holding of investments and does not necessarily establish unitary business ties. For instance, in the case of Container Corp. v. California Franchise Tax Board, the court held that a distinction must be made between capital transactions that had an <u>operational function</u> and those that merely had an <u>investment function</u>. The court stated that the required flow of value had to be demonstrated by something more than the mere flow of funds arising out of a passive investment or a distinct business operation.

The determination of functional integration through the exercise of strong centralized management must be based on the facts of each case. Generally, several factors of functional integration will be present in a unitary business. A UBG can exist however based on only a few factors or even one, if the factor or factors are particularly significant to the business operations. For example, if one company purchases raw materials which are used in a manufacturing process by a second company and 100% of the first company's sales are made

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to the second company, that factor alone could be significant enough to prove functional integration exists between the two companies.

Some major unitizing factors follow. The presence or absence of one or more of the factors does not necessarily mean that functional integration does or does not exist. The factors are listed in descending order of general importance based on unitary case law. Again, the actual significance of any of the factors depends on the type and nature of the businesses involved. However, the absence of ALL of the first five factors will generally indicate a lack of functional integration between the companies. The actual information and documentation that is necessary to support the conclusion that any of these factors exist in a specific group is discussed in the “Development of and Support for the Unitary Determination” section.

A. MAJOR UNITIZING FACTORS

1. Intercompany Transactions

Various intercompany sales, exchanges, product transfers, providing of services and intangibles can be a significant factor. The significance of intercompany sales will be based on both the character of the item sold and the ratio of the intercompany sales as compared to the total sales made. As the percentage of intercompany sales increases, so does the importance of this factor. Any amount of intercompany sales takes on greater significance, however, if:

a) There is a limited sales or purchasing market for the product involved; or

b) There are valuable trade names or other intangibles associated with the sales.

The taxpayer may attempt to minimize the significance of the intercompany sales activity by showing that the sales are taking place at fair market or arm's-length prices. The selling price is not the only factor of importance. Intercompany sales are one of the important criteria of functional integration because they reflect an assured market for the seller and a guaranteed source of supply for the purchaser.

2. Common Marketing

If the various entities share common marketing features that result in an advantage to the individual companies which would not be present if they were not part of the group, these features can be an important sign of functional integration. Common marketing exists when:

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a) A substantial portion of the group's products, services, intangibles, etc. are distributed or sold to a common customer. The common customer is not necessarily one entity or even an affiliated group of companies. A certain type of customer could also qualify, such as, grocery stores, retail stores, lawyers, doctors, etc. The importance of this factor is that the companies are receiving a benefit (e.g. shelf space, product referrals to clients/patients) from being a part of a group of companies, which they may not receive if they were on their own.

b) The companies use a common trade name, trademark or logo that is a significant factor in a customer's decision to purchase the products or services. An affiliated group that has set up an intangible holding company to hold the trademarks, trade names and similar intangibles of the group, and to which the affiliates pay royalties for the use of the intangibles, is evidence of functional integration. This is especially true if the intangibles were contributed to the holding company, rather than sold at arm's-length prices, and if the costs of administering and protecting the intangibles are incurred by affiliates other than the holding company.

Common use of an advertising agency (whether it is an independent agency or an affiliated company) usually does NOT, in itself, constitute common marketing. The value of common marketing is that it allows one company to benefit from the goodwill of another. The use of a common advertising agency does not necessarily cause this to happen.

3. Transfer or Pooling of Technical Information

The transfer or pooling of technical information, know-how, or research and development can be a significant factor of functional integration if the pooling yields an economy of scale or the information shared is of particular importance to the companies' operations. Sharing of accounting or legal services is not usually considered a significant pooling of resources; however, depending on the type of companies involved, these functions may take on greater importance. For instance, when dealing with a group of utility companies or other regulated companies, the sharing of a legal staff could provide the companies, as a group, better representation at the industry's regulatory meetings, hearings, etc. than any one of the companies would have alone.

4. Common Distribution System

A common network for the control and accounting, storage, trafficking, and transportation of inventory can also be evidence of functional integration between the companies. Common warehousing alone, however, is not normally considered a significant factor.

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5. Common Purchasing

The common purchasing of a substantial quantity of products, services, intangibles, etc. from the same source can also be an important factor when determining whether or not companies are functionally integrated. When purchasing as a group results in an economy of scale for the companies or where the items, services or rights are not readily available from other sources and are important to the group's operations, the purchasing becomes a more important factor. As discussed above, under COMMON MARKETING, the importance of this factor is the economic benefit received by the companies by purchasing as a group rather than as a separate company, not from whom the purchasing is done.

6. Intercompany Financing

Intercompany financing has always been considered a major unitary tie. The decision in the Container Corp. case however, contained the additional requirement that the intercompany financing must be made for an **operational purpose** rather than merely as an investment function in order for it to be considered a significant unitizing factor. This type of intercompany financing is commonly known as a cash management system. It is, therefore, a cash management system that must be present to support a unitary business conclusion and not simply intercompany financing.

In the case of Citizen's Utilities Company of Illinois v. The Department of Revenue, the type of intercompany financing present was felt to be a very significant unitary factor. In discussing the reasons for allowing a unitary return to be used in Illinois, the decision states:

> Finally, and perhaps most illuminating, is the parent's use of the intercompany [bank] account. As previously noted, the account gives the parent access to revenues received by all its subsidiaries. The parent can withdraw revenues from one subsidiary and invest them in the form of an interest-free loan with another subsidiary. Both the borrowing and lending corporations are governed by the same directors, officers and management strategies, so the lender controls how the loan is used and the investment cannot be considered passive within the meaning of Container Corporation. By these transfers, the revenue-producing subsidiary loses income from the time-value of its revenues, and the borrowing subsidiary's income is increased by eliminating interest.

A synopsis of the Citizen's Utility Company case appears in Chapter 49.

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Intercompany financing is therefore a significant unitary factor only when the financing contributes to the functional integration of the business segments. Some indications of the cash management system that would help to establish a unitary group would be:

1. A pooling of investments to obtain better returns on the investment.

2. Centralizing loan requests for cash needs in order to obtain the best borrowing rates available and then allocating the funds back to the individual entity, based on their need.

3. Centralizing the budgeting process including such things as funds for expansion, capital improvements, etc.

4. Centralizing the approval tolerances for spending by the various entities.

5. Shifting of cash from one entity to another to maintain a stable economic position for all of the entities involved.

6. Centralizing other types of financial controls

B. Other Factors

The following list of factors would not, either alone or in combination with other factors on this list, normally be sufficient to prove functional integration. They can, however, help to support a determination of functional integration based on one of the above significant factors. These factors include common or intercompany:

1. Labor Relations
2. Pension Plans
3. Insurance
4. Personnel Recruitment
5. Intercompany Personnel Transfers
6. Legal Services (except as described above)
7. Computer Services
8. Centralized Accounting
9. Tax Administration
10. General Administrative Services

Once it has been established that functional integration exists through the exercise of strong centralized management, the group of companies involved may be considered to be in a unitary business relationship.

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The following information should be obtained to further support a unitary determination. In most instances, interdependence ONLY in these areas is not enough to substantiate the formation of a unitary business group, however, as always; they must be evaluated on a case by case basis.

1. Labor Relations

   a) Is the workforce of the parent and/or any of the subsidiaries represented by the same labor union, local or bargaining unit?

   b) Does the parent negotiate or approve any of the subsidiaries' contracts?

   c) Do the parent and/or any of the subsidiaries negotiate a common labor contract?

2. Pension Plans

   a) Describe in detail EACH pension plan of the group, indicating which categories of officers or employees are eligible for each plan, whether it is contributory or noncontributory, its general provisions as to when benefits become payable, and indicate to what extent it involves any stock option provisions. (If a stock option plan is a separate plan, explain its program separately.) Indicate to what extent one of the affiliates administers each plan and, if not, name the outside firm responsible for its administration.

   b) Indicate to what extent, if any, officers and/or employees of other affiliates are eligible for any of affiliate's pension plans. If they are eligible, identify which particular principal affiliatesare presently included in each of the plans and which principal subsidiaries are not included.

   c) Provide the same information as above for each pension plan at each principal affiliate.

3. Insurance

Typical types of insurance carried by the parent and its subsidiaries would include (1) fire, (2) comprehensive casualty, (3) theft, (4) group health, (5) group life, and others.

   1. For insurance held by the parent, identify the specific type of coverage it has. In any instance where more than one type of coverage is negotiated through a single agent, identify the agency and the particular types it handles. Indicate to what extent any type of insurance coverage is

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negotiated separately at the division or other unit level rather than as an overall coverage for the entire parent corporation.

2. As to the principal subsidiaries explain, for EACH, which particular type or types of insurance coverage is obtained through the same agent or agents which the parent above utilizes and the extent, if any, of any premium reductions which might result from this broader base of insurance coverage.

3. Identify each subsidiary which independently negotiates its own insurance coverage.

4. Does the parent or another affiliate administer casualty insurance policies for any common facilities?

5. Are common group insurance plans available for any employee of the parent and/or any of the subsidiaries?

6. Does the parent and any of the subsidiaries utilize a common or similar workers' compensation insurance policy?

7. Are the parent and/or subsidiaries self-insured, or do they insure through a captive insurance company?

4. Personnel Recruitment/Policies

Training Programs and Manuals

Either or both of these methods can be utilized by a corporation for such matters as sales training, service training, internal accounting procedures, programs to train people in technical skills for key manufacturing positions, employee or personnel manuals, etc.

1. Obtain a detailed description of each of the major operational and administrative areas for which the parent has developed and uses written manuals. Are these manuals used by any of the subsidiaries?

2. Explain which of these, if any, are likewise utilized by any principal subsidiary. Explain which principal subsidiaries use these manuals and which do not.

3. Obtain a description of each type of major periodic training program or school conducted by the parent. Indicate how many people and at what

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position levels are trained annually under each program and the specific scope of the program coverage.

4. Indicate the extent to which people from which principal subsidiaries, if any, are involved in each of the programs or schools identified above.

5. Intercompany Personnel Transfers

These may be significant depending on the number of transfers and the level of the officer or employee positions involved.

1. For EACH person who became a NEW officer of the parent corporation during the audit years, find out which of them, if any, had previously been an officer or key employee in a subsidiary of the parent. Give the name of each, the position formerly held in the subsidiary, the year each became an officer in the parent, and the number of prior years' service in that subsidiary or any other affiliated corporation.

2. Obtain a list of any NONOFFICER key-employee transfers between affiliates for each audit year. These would include persons at a supervisory level or above at production plants, distribution centers and on administrative staffs, management analysts, key computer personnel, etc. Identify each such key person by name, the year of transfer, the old position held in which affiliate, and the new position held in which affiliate. The list should also include transfers between the parent and subsidiaries and also transfers between subsidiaries.

3. Are there any common personnel policies and procedures implemented or utilized by the parent and/or any of the subsidiaries?

4. Are there any common hiring policies between the parent and any of the subsidiaries?

5. Do both the parent and/or any of the subsidiaries use any common pre-employment tests or screening procedures?

6. Do executives of the parent travel to locations including, but not limited to, manufacturing facilities, office facilities, selling facilities or shipping facilities of any of the subsidiaries?

7. Do executives of any of the subsidiaries travel to the corporate headquarters of the parent?

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8. Have officers and/or employees of the parent or an affiliate transferred to any of the subsidiaries?

9. Have officers and/or employees of any of the subsidiaries transferred to the parent or another subsidiary?

10. Does the parent approve promotions, salary increases, bonuses or other personnel actions of the affiliate's management personnel?

11. Do the employees of the parent and any of the subsidiaries have a common policy and procedures manual?

6. Legal Services

1. Describe the specific services performed by the legal staff of the parent. Also include the number of attorneys on that staff.

2. Describe which particular subsidiaries, if any, are provided services by the legal staff described above. Explain what services it provides for each such subsidiary, and the parent.

3. Explain to what extent and for what specific services private law firms are retained by the parent, or by any particular subsidiary, and indicate to what extent, if any, the same law firm regularly provides services to more than one affiliate.

7. Computer Services

Any major parent corporation today will probably have its own computers to provide a wide variety of services for itself and possibly its subsidiaries.

1. Obtain a list of each location where the parent corporation maintains computer facilities or a data processing system. Explain what type of processing is being performed at each location (such as production data, sales data, inventory control data, shipping data, personnel data, accounting data, etc.) and obtain a complete description of the scope covered by each.

2. Does the parent charge the subsidiaries for these types of services?

3. Obtain a list of each location where each subsidiary maintains computer facilities or a data processing system. Provide the same information as above for each location. Explain the extent to which each of these

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locations is tied in with one or more computer facilities of the parent to receive or exchange particular data. Also indicate which ones are not using the parent's facilities.

4. Do any of the subsidiaries charge the parent for any other administrative data processing functions?

8. Centralized Accounting

1. Is there a common Chart of Accounts for the parent and subsidiaries?

2. Does the parent or an affiliate perform the accounting functions for any of the subsidiaries?

3. Do the parent and/or any of the subsidiaries use the same system of accounting? Which subsidiaries do not use the system?

4. Do the parent and/or any of the subsidiaries use the same accounting data processing system? Which subsidiaries do not use the system?

5. Are the accounting reports for any of the subsidiaries prepared by the parent or by the parent's data processing system?

6. Do any of the subsidiaries prepare operational reports for use by the parent?

7. Is the payroll of any of the subsidiaries prepared by the parent or by the parent's data processing system?

8. Are any of the subsidiaries charged by the parent for accounting services?

9. Do auditors of the parent audit the books and records of any of the subsidiaries?

10. Do the internal auditors of the parent perform the same functions for any of the subsidiaries?

9. Tax Administration

1. Do the parent and/or any of the subsidiaries use the same CPA firm?

2. Does the parent prepare income tax returns for any of the subsidiaries?

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3. Does a common CPA firm prepare the income tax returns for the parent and any of the subsidiaries?

10. General Administrative Services

1. There may be centralized services rendered at the headquarters of the parent or subsidiaries for itself and some or all subsidiaries other than those services separately covered elsewhere in this check list. If so, describe each of them and indicate to what extent they also are for the benefit of any particular subsidiaries. These could include items such as public relations, affirmative action, governmental regulations, etc.

2. The costs of centralized services may or may not be charged to subsidiaries for whose benefit they are performed. If the parent does apportion these costs, determine the total costs for each audit year, the specific items of service or activity by the parent which these costs represent, the actual amount charged to each principal subsidiary, an explanation of the method or methods used for apportioning these charges to the subsidiaries, and the name of each principal subsidiary which was not charged any portion of these costs.

3. Does the parent sell these services to any of the subsidiaries?

4. Does the parent purchase these services from any of the subsidiaries?

5. Do any of the subsidiaries or affiliates purchase/sell these services from/to other subsidiaries?

6. Does the parent or any of the subsidiaries sell these services to persons outside the group?

7. Is there a centralized relocation program utilizing a major (or company owned) moving company, a real estate company, finance company, etc.?

In conclusion, it must be remembered that the above items are an attempt to provide guidelines for the support of a unitary determination. Not all of the items will be pertinent to every case.

The extent of the evidence necessary to support the determination will depend on the nature of the businesses, the manner in which the companies originally filed their Illinois returns, etc. Whether or not the taxpayer agrees with the auditor's conclusions can also be a factor in the amount of support necessary, however, it is important not to rely too extensively on this factor since the

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taxpayer's opinion might change, a higher ranking official for the group might disagree or the company might simply pay the audit and protest the determination by filing claims. In any of these situations it could be much harder at the later date to obtain any additional information necessary to support a unitary determination than it would have been in the initial audit proceedings.

X. 80/20 COMPANIES

The Department, by definition, uses a waters-edge, domestic combination approach to exclude from the unitary group members with 80% or more of their business activity performed outside the United States.

In addition to determining the composition of the unitary business group, the 80/20 company test is used in determining the amount of sales, which should be excluded from the Illinois numerator of the sales facto under IITA § 304(a)(3)(B)(ii).

For more information regarding the Sales Factor, refer to Chapter 27.

When performing the 80/20 company test:

1. The term “the United States” includes only the fifty states and the District of Columbia. It does not include any territory or possession of the United States or any area over which the United States has asserted jurisdiction or claimed exclusive rights with respect to the exploration for or exploitation of natural resources, such as the Outer Continental Shelf. REF: IITA § 1501(a)(27).

2. The means by which the business activities within the United States are measured will depend upon which apportionment method the company is required to use under IITA § 304.

86 IAC §100.9700(c) defines the mechanics on how to determine whether a company is excluded from the UBG as an 80/20 company or not, as well as excluded Illinois sales under IITA § 304(a)(3)(B)(ii). The appropriate factors to be used in the 80/20 test for different apportioning groups (i.e. IITA § 304 (a), (b), (c), or (d)) apportionment is defined here as well.

86 IAC §100.9700(c)(2)(B) states that the computation of the 80-20 U.S. **business activity test** requires the formation of one or two fractions, as the case may be. These fractions are then averaged to arrive at an overall U.S. business activity in relation to world-wide business activity. The numerators of the fraction represent U.S. property, and U.S. payroll and the denominator represents property and payroll worldwide. If two fractions are present, divide by two. If property or payroll is absent the fraction is divided by one.

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When performing the 80/20 company test for an IITA § 304(a) company, property and payroll within the US, and property and payroll everywhere are formed into two fractions, and averaged together.

$$\frac{\text{Property outside the US}}{\text{Total Property Everywhere}} + \frac{\text{Payroll outside the US}}{\text{Total payroll everywhere}} \quad /2$$

For example if property were .75, or 75%, outside the U.S. and payroll were .95 or 95% outside the U.S. adding the .75 and .95 together and dividing by two would yield a combined .85 or 85% level of activity outside the U.S. This company would not be included as a member under the 80/20 provisions.

The figures shall be the gross figures without any elimination. If the entities involved fall under different apportionment treatment under IITA Section 304 for transportation, insurance, or financial organizations: the numerators will include, "U.S. revenue miles, insurance premiums on property or risk in the U.S. or financial organization business income from sources within the U.S.; the respective denominators are world-wide figures."

- If the person would normally be required to use the formula described in IITA § 304(b) for insurance companies, the test is computed as the ratio of insurance premiums on property or risk in the United States to the worldwide premiums.

- If the person would normally be required to use the apportionment formula described in IITA § 304(c) for financial organizations, the test is computed as the ratio of financial organization business income from sources within the United States to worldwide business income.

- If the person would normally be required to use the apportionment formula described in IITA § 304(d) for transportation companies, the test is computed as the ratio of revenue miles in the United States to Worldwide revenue miles.

Whichever formula is applicable, the figures used should be gross amounts without any elimination, as the elimination of intercompany transactions is appropriate only after it is determined that the two parties are part of a UBG. REF: 86 IAC §100.9700(c).

If either the **property** fraction **or** the **payroll** fraction is zero, the sum of the fractions is divided by one. The companies must have in excess of 20% of their business activities within the United States to be included in the UBG and the companies must be required to use the same subsection of Section 304 of the IITA to apportion their income.

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Property outside the US / Property Everywhere	(.75)	Payroll outside the US / Total payroll everywhere	(0)	(.75) / 1 = 75%
Property outside the US / Total Property Everywhere	(0)	Payroll outside the US / Total payroll everywhere	(.95)	(.95) /1 = 95%

In the event that if either property or payroll were zero, the result would have the remaining factor divided by one. If it were .95 as in the above example, .95 would be the factor and the company would **not be** included as a member under the 80/20 provisions. If the factor were .75, it would fail the 80/20 test and it **would be** included within the group.

If both property and payroll are zero, the company cannot be an 80-20 company because none of its business activity is outside the U.S.

In computing the property fraction of the 80/20 test, only **property** which is used, **available for use** or **capable of being used** during the tax year in the production of business income should be included. Only real and tangible property is considered in this calculation. Intangible property and property which is used in the production of non-business income, construction-in-progress or property which is permanently withdrawn from use should not be included. REF: 86 IAC § 100.3350(a) and (b).

The 80/20 company test should be performed using the **common accounting period** of the UBG of which the company in question might be a part. Generally, the accounting period of the parent of the possible UBG is used. If there is no common parent, the common accounting period can then be determined on the basis of the accounting period of the member filing an Illinois return who is expected to have, on a recurring basis, the greater or greatest Illinois tax liability. The proration of factors can be done on a specific accounting basis or using the number-of-months method. REF: 86 IAC §100.5265(b)

For potential members which would be entering or leaving the UBG during the taxable year, the 80/20 company test should be applied only to the company's business activities during that part of the year for which the prospective member otherwise qualifies for membership in the UBG. REF: 86 IAC § 100.9700(c)(2)(C).

The property and payroll calculated in the numerator may be stated by the company as a directly paid cost of office ownership, lease or rental, and payroll may be stated through dedicated employees that are paid directly by the foreign operating company. However, the foreign operative may have an arrangement with its U.S. based affiliates and the amounts paid may be more indirect. There are several areas to review when determining the correct amounts to be included in the numerator.

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If a corporation is using the property of another entity free of charge (or for a nominal fee), the net annual rental rate for the property in the computation of the property fraction of the 80/20 test of the corporation using the property will be determined on the basis of a reasonable market rate for such property. REF: 86 IAC §100.3380(b)(2).

If a corporation pays a management fee to another entity for (among other things) property being used, the amount of the fee constituting rental reimbursement for the property (or, if this is a nominal amount, a reasonable market rental rate) can be considered rent expense of the corporation using the property and can be included in the computation of the property fraction for the 80/20 test.

A few areas that the auditor may want to question follow.

- Has the foreign corporation hired employees and management directly in the U.S? Or, does the foreign company rely on the management and employees of its U.S. affiliated companies?

- If the U.S. company(s) is performing work for the foreign company, using its U.S. employees and their U.S. office space, what costs may be imputed from these activities? The fair market value of these considerations should be included in the property and payroll numerator.

- The situation may arise where the taxpayer attempts to attribute property or payroll as being US based in order to claim an NOL. The taxpayer may attempt to argue that a portion of U.S. property that was federally capitalized as an intangible asset was actually tangible property and should be used in the 80/20 calculation. The use of property and payroll should be verified for its nature (tangible or intangible), its country of use, and the situation that it is presented in (inclusion for NOL use or its exclusion for tax avoidance) by the taxpayer.

- Who are the corporate officers of the company, and where are they located? A corporate officer is an employee of the corporation if he or she performs services for the corporation and is compensated for that service, directly or indirectly. Treas. Reg. § 31.2121(d)-1(b). An officer or other employee of the parent company who is also a corporate officer of a subsidiary is an indication that the two are unitary, and his or her compensation attributable for services performed for the subsidiary could be US payroll for purposes of the 80/20 test.

Further reference is provided in 86 IAC § 100.3350 for the property factor and 86 IAC § 100.3360 for the payroll factor. A list of waters-edge states is provided in the Exhibits Section. The Audit Manual Chapter 27 discusses the property and payroll factors in detail in the Historical Extracts and Exhibits section.

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A. 80/20 DISREGARDED ENTITY

If a disregarded entity (DE) is entirely foreign in operation, with no US payroll or property, but is owned by a US corporation the 80/20 provisions do not apply in the usual manner. IITA § 102 provides that any term used by IITA shall have the same meaning as when used in comparable context in the United States Internal Revenue Code of 1954.

86 IAC § 100.9750(b)(1) states that any entity treated as a corporation for federal income tax purposes must be treated as a corporation for all purposes of the IITA, and that no entity (other than a cooperative) that is not treated as a corporation for federal income tax purposes may be treated as a corporation for purposes of the IITA. Any entity that elects not to be treated as a corporation separate and distinct from its owners is not a corporation separate and distinct from its owners for Illinois income tax purposes. Consequently, an entity that elects to be disregarded as an entity separate and distinct from its corporate owner pursuant to Treasury Regulations Section 301.7701-3(a) and its corporate owner are a single corporation for all purposes of the IITA. 86 IAC§ 100.9750(b)(1)(A).

Under IITA §§ 102 and 203, the federal treatment of a disregarded entity and its owner applies for Illinois income tax purposes. An entity that is disregarded for federal income tax purposes is disregarded as an entity for Illinois purposes, and the items of base income of the disregarded entity are considered the items of the owner and are taken into account in computing the Illinois base income of the owner. The same treatment extends to the determination of the apportionment factor of the owner of a DE. The activities of the DE are considered the activities of the owner for purposes of applying the apportionment provisions of IITA Article 3.

For purposes of the IITA, the DE's are treated as disregarded. All items of income and loss, as well as the apportionment factors of the DE's, would be included on the parent company's return. Ref: GIL IT 14-0012

If the DE were a US company controlling and holding foreign companies the situation would not apply. Because the US entity were considered disregarded, the 80/20 test would use the DE's parent company's property and payroll along with its own, and any other parent held DE. It would not be considered to be a separate entity from the parent.

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XI. UNITARY PARTNERSHIPS

86 IAC § 100.9700 contains the unitary business group rules. Originally, 86 IAC § 100.9700(b) provided that unitary groups could include individuals, trusts & estates, and partnerships as well as corporations. On July 8, 1987 that regulation was amended to provide that only corporations may be members of a unitary business group and 86 IAC § 100.3380(d) [originally § 100.3700(d) and later § 100.3380(c)] was adopted to provide for special apportionment method for corporate partners who are unitary with their partnerships. At the time this section stated: "When the activities of a corporate partner... and the activities of a partnership, disregarding ownership requirements, constitute a unitary business relationship, then the partner's share of the partnership's income and factors shall be combined with the business income and factors of the partner..." As the Department interpreted these rules, § 100.3380(d) only allowed the income and factors of a partnership to flow-up to a corporate partner based on that partner's percentage of ownership in the partnership. Non-corporate partners (including other partnerships in a tiered partnership structure) could not be unitary with their partnerships and the apportionment rules in IITA § 305(a) would apply.

86 IAC § 100.3380(d) was amended effective for tax years <u>beginning</u> on or after June 20, 2002, to require flow-up of a partnership's business income and factors to any unitary partner. Some taxpayers could apply the regulation retroactively as explained later in this section.

For many years the Department took the position that a corporate "general" partner in a partnership was automatically unitary with its partnership while a "limited" partner was not unitary. That policy was in error. The unitary requirements for a partnership are the same as for corporations, except that the provision in IITA §1501(a)(27) requiring more than 50% ownership applies only to ownership of corporations. The ownership requirements for partnerships may be met by a smaller percentage.

86 IAC §100.9700 was amended June 30, 2008 to clarify effective control of a partnership. In 86 IAC §100.9700(e) the language was changed to include not only common ownership being a corporation owning or controlling more than 50% of outstanding stock, but any other entity that possesses <u>direct or indirect ownership sufficient enough to exercise control</u> over the activities of the entity. An example of this relationship would be found where ownership of a general partnership interest gives the partner the authority to act on behalf of the partnership and bind the partnership, <u>regardless of actual ownership share.</u>

Note: This change is effective for all tax years.

Nothing in IITA § 1501(a)(27) prevents a limited partner from being unitary with the partnership as long as the unitary criteria are present. If the auditor determines that a partnership is unitary with a partner, then comments will be included in the auditor's report as to why the partnership meets the unitary criteria in IITA §1501(a)(27).

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A. PARTNERSHIPS OWNED MORE THAN 90% BY PARTNERS

Starting with tax years beginning on or after June 30, 2008 (calendar year 2009) unitary partnerships, other than publicly traded partnerships, owned more than 90% by its unitary partners are included on the Schedule UB. In that case the income and factors of the partnership will be included on the Schedule UB following the instructions for the 2013 and later forms. Intercompany income and sales between the partnership and the unitary group will be eliminated under 86 IAC § 100.5270. The IL-1065 will be completed on a "separate unitary basis" (same as a unitary IL-1120-ST) as defined in 86 IAC § 100.5201(a)(l) and will share in the unitary income and unitary everywhere factors from the Schedule UB.

> Note**:** A publically traded partnership is specifically excluded from this provision under 86 IAC § 100.3380(d)(4) and cannot be included on the Schedule UB. However a publically traded partnership will still flow-up its income and factors to a unitary partner under 86 IAC §100.3380(d)(2).
>
> **Example**
> In 2008 and 2009 an individual owns 100% of corporations A and B that operate car dealerships and 50% of Partnership C, which owns the real estate used by the dealerships. The remaining 50% of Partnership C is owned by corporations A and B. The auditor determines that a unitary relationship exists between Corp A and B, and Partnership C. In 2008 only the corporations can be unitary because they are owned by the same individual. However starting in 2009 the partnership can be included in the unitary group and listed on the Schedule UB under 86 IAC § 100.3380(d)(4). The individual and each of Corporations A and B are "related parties" under IRC § 267(b)(2), so the individual's ownership share is included with the ownership shares of actual members of the unitary group (Corps A & B) in determining the greater than 90% rule.

If a corporation member of the unitary group itself owns an interest in the partnership, then the partnership will be allowed the subtraction modification for income distributable to entities subject to replacement tax for that partner's share of its base income. In addition, if the unitary partnership received any Illinois nonbusiness income or Illinois non-unitary partnership income, that income, net of the share that is distributable income, net of the share that is distributable to a partner subject to replacement tax, would be subtracted from base income in the computation of apportionable business income under the IL-1065 instructions found in Step 6, lines 37 and 38 for 2009 and lines 36 and 37 for subsequent years.

- Write the amount of all nonbusiness income or loss included in base income, net of any related deductions
- plus any recaptured business expenses from Illinois Schedule NB, Column A

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- and any amount distributable to partners subject to replacement tax, from Illinois Schedule NB, Column A
- Include any nonbusiness income from Illinois Schedules K-1-P or K-1-T.

For the TYE 2009 Step 6, Line 38 (line 37 for subsequent years), the IL-1065 instructions provide to:

Write the amount of all **non-unitary** business income or loss included in base income received from any partnership, trust, or estate, of which you are a partner, or a beneficiary, net of any amount distributable to partners subject to replacement tax.

Any Illinois partnership income that flows through to other members of the unitary group will be allocated under IITA § 305: Allocation of Partnership Income by Partnerships and Partners Other Than Residents (86 IAC § 100.3500). Therefore, if the partnership is owned by other members of the unitary group, such as C-Corps, the income that flows through to the IL-1120 from the unitary partnership will be reported on the pass-through lines for non-unitary partnership income. There's no place else to report the pass-through income on the IL-1120. Therefore, if the C-Corps on the Schedule UB own 100% of the partnership, the IL-1065 will show no RT tax liability even though it reports an Illinois apportionment factor because of the subtraction modification for income distributed to entities subject to replacement tax. The RT tax and IT tax will be paid on the groups combined IL-1120, where the business income of the partnership apportioned to Illinois on the separate unitary basis will be included on the Illinois business income from non-unitary partnerships line.

The instructions for the Schedule K-1-P(1) provide guidance for partnerships on how to report the partnership income and apportionment factors to its holding partner when this partner is either unitary or non unitary.

The instructions for the Schedule K-1-P(2) provide guidance for the partner to report the income and apportionment shares that its partnership had reported to it on the Schedule K-1-P in a unitary or non unitary relationship. To determine its portion of business income from a unitary partnership that is not substantially wholly owned by the members of the UBG that is taxed by Illinois, the partner must include its unitary share of the partnership's income and apportionment factors with its own business income and apportionment factors. If the unitary partnership is substantially wholly owned by members of the group, the partnership's business income is apportioned to Illinois using separate unitary apportionment, and the group's share of that income is included on the line for nonunitary partnership business income apportioned to Illinois (line 33 of the 2014 form).

Prior to the amending of the IL-1065 instructions, the pass-through income to the unitary partners was reported by preparing a pro forma IL-1065 using the instructions that

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existed for reporting pass-through income from an Illinois partnership on an IL-1023-C. Those IL-1023-C instructions stated:

> "Use a blank Form IL-1065 as a worksheet and complete Steps 4 through 6. Write the amounts from Line 14, of partnership's return. Write zeros on Lines 21 [amount of loss distributed to partner subject to replacement tax], 26 [personal service income], and 27 [share of income distributed to a partner subject to replacement tax]. On Line 20, write the amount of any guaranteed payments made to a partner included in this composite return."

B. INTERCOMPANY ELIMINATIONS – TAX YEARS BEGINNING ON OR AFTER 6/30/2008

86 IAC §100.3380(d)(2)(A) was amended effective for tax years beginning on or after June 30, 2008 (calendar year 2009). This amendment provided that:

- The partner's distributive share of the business income and apportionment factors of the partnership shall be included in that partner's business income and apportionment factors.

- In determining the business income of the partnership, transactions between the unitary partner (or members of its unitary business group) and the partnership shall not be eliminated.

- However, all transactions between the unitary business group and the partnership shall be eliminated for purposes of computing the apportionment factors of the partner and of any other member of the unitary business group.

  EXAMPLE
  As indicated in the worksheet below partner and partnership are engaged in a unitary business. Partner owns a 20% interest in the partnership. Partnership has $10,000,000 in sales Everywhere, $3,000,000 of which are to the partner, and $4,000,000 in Illinois sales, $1,000,000 of which are to the partner. In computing its apportionment factor, the partner will include $1,400,000 from partnership in its Everywhere sales (20% of partnership's $10,000,000 in Everywhere sales, after eliminating the $3,000,000 in sales to partner) and $600,000 from partnership in its Illinois sales (20% of partnership's $4,000,000 in Illinois sales, after eliminating the $1,000,000 in sales to the partner). Also, the partner must eliminate any sales it made to the partnership.

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The following schedule illustrates the example in 86 IAC § 100.3380(d)(2)(A):

Partner owns 20% of unitary partnership			
	~~	Partnership	~~~~~~~
	Non-IL	ILL sales	TL Sales
Total outside sales	4,000,000	3,000,000	7,000,000
Total sales to partner	2,000,000	1,000,000	3,000,000
Total Line 1 sales	6,000,000	4,000,000	10,000,000
	Reported on IL-1065		
20% partnership flow-	~~~~~~~	Partner	~~~~~~~
up to partner:	Non-IL	ILL sales	TL Sales
Total line 1 sales	6,000,000	4,000,000	10,000,000
Less intercompany	2,000,000	1,000,000	3,000,000
total net sales	4,000,000	3,000,000	7,000,000
20% flow-up	800,000	600,000	1,400,000
	Included in sales factor on IL-1120		

Under the former rule for tax years beginning prior to June 30, 2008, there was no sales elimination between a unitary partner and a partnership or vice versa, unless that elimination is allowed under IITA § 304(f). Under the revised rule sales eliminations are allowed on any intercompany sales that would be included in the sales numerator or denominator of a unitary filer.

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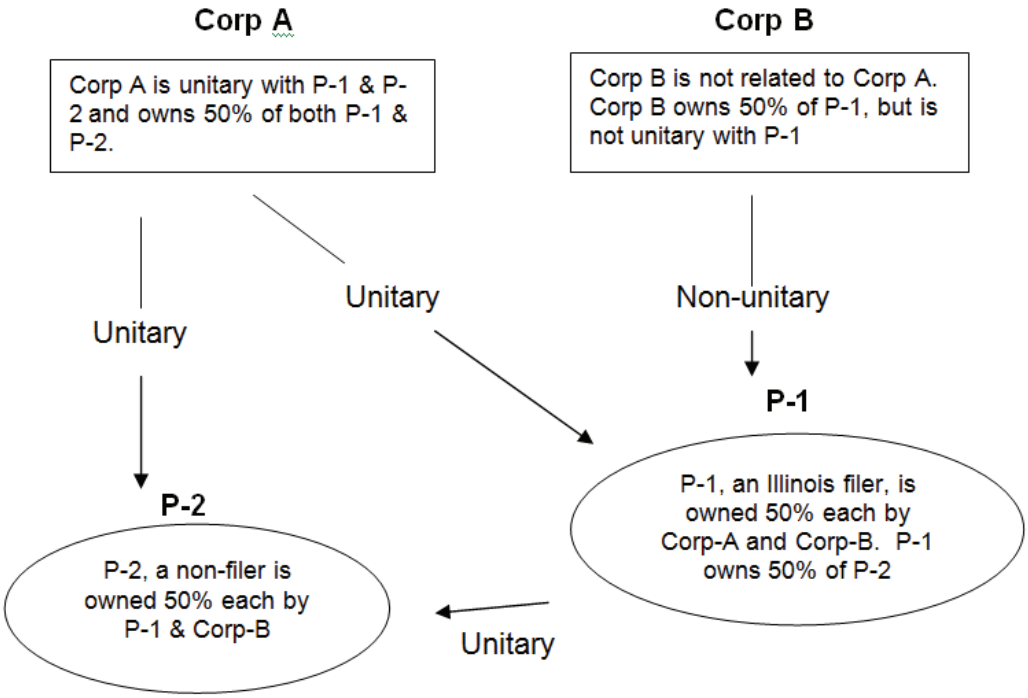
C. EXAMPLE – NEW RULES - UNITARY MULTI-TIERED PARTNERSHIP

1. Ownership Flowchart



All four entities use a calendar year. For calendar year 2012 Corp A and Corp B are partners in P-1. Corp A is unitary with P-1 and P-2. Corp B is not unitary with P-1.
Corp A and Corp B are each 50% partners in P-1.

- Corp A and P-1 are each 50% partners in P-2.
- P-1 earned $100 profit on rental property in Illinois.
- P-2 had a ($400) loss on rental property in Ohio. P-2 is a non-filer.
- Assume that the rental receipts received by P-1 are $10,000 allocated to Illinois and that the rental receipts received by P-2 are $20,000 allocated to Ohio.

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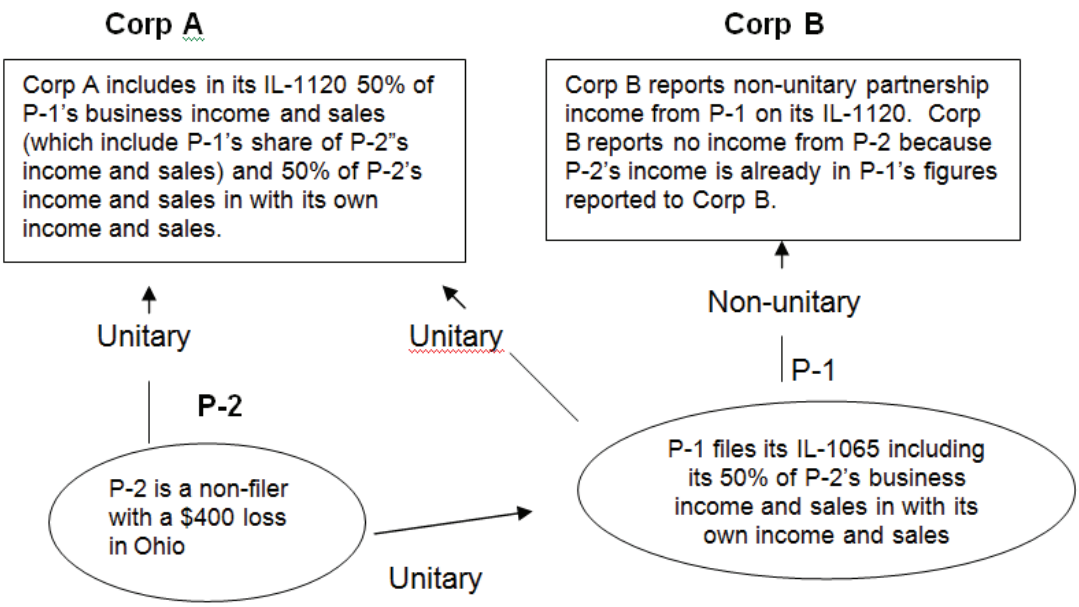
2. Income Flowchart



Corp A, Corp B and P-1 should file their 2012 returns as follows:

Because P-1 and P-2 are unitary, P-1 must apportion its business income to Illinois by including its 50% share of P-2's business income with its own business income and by including its 50% share of P-2's Everywhere sales with P-1's own Everywhere sales. Line 1 of the IL-1065 of P-1 would show negative $100 [$100 + ($-400 x 50%)], which is $100 of its own income plus 50% of the loss from P-2. P-1's Illinois apportionment factor is 50% which is P-1's $10,000 numerator, divided by $20,000 consisting of P-1's sales Everywhere of $10,000 plus P-2's denominator flow-through of $10,000 ($20,000 x 50%). Ignoring the subtraction modification on the IL-1065 for income distributable to partners subject to replacement tax, P-1's apportioned Illinois income on its IL-1065 is a $50 loss ($-100 x 50%).

Because Corp A is unitary with P-1 and P-2, Corp A would include its share of P-1 and P-2's business income with its own (Corp A's) business income (Already included in federal taxable income on the U.S. 1120). Also Corp A would include on its IL-1120 its 50% share of P-1's Illinois sales and Everywhere sales from P-1's IL-1065. The flow-through factors from P-1 are Illinois sales of $5,000 ($10,000 x 50% ownership) and sales everywhere flow-through from P-1's IL-1065 of $10,000 (P-1's $10,000 in sales Everywhere plus P-1's 50% share of (P-2's sales Everywhere of $20,000, x Corp A's 50% share of P-1).

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On its 2012 IL-1120 since Corp B is not unitary with P-1, Corp B must allocate its income separately from P-1. Corp B's U.S. 1120 federal taxable income already includes its 50% share of P-1's gross income $-50 ($-100 x 50%). Therefore this income needs to be backed out of base income on the IL-1120, Part III, line 2b. Corp B then includes on its IL-1120, Part III, line 8 its 50% share of P-1's Illinois net loss reported on P-1's IL-1065 of $-25 (-$50 x 50%).
Note: No income or factors from the partners ever flow down to a lower tier partnership. In the above example, although P-1 and P-2 are unitary, no business income or factors of P-1 flow down to P-2. Also, no income or factors of Corp A flow down to P-1 or P-2.

The following is an example of a unitary, multi-tiered partnership applying the rules prior to years beginning on June 20, 2002.

D. UNITARY CHANGE – TAX YEARS BEGINNING ON OR AFTER 6/20/2002

Effective for tax years beginning on or after June 20, 2002, 86 IAC § 100.3380(d) was amended so that any unitary partner, and not just corporate partners, must include in its business income and apportionment factors its partnership share of the business income and factors of the partnership (including a publically traded partnership). If the partner is itself a partnership, it will include the business income and factors flowed up to its unitary partner, or in the case of a nonunitary partner, in the computation of Illinois income that partner must include in its net income under IITA § 305(a).

Note: If the partnership is owned greater than 90% by a unitary partner for a tax year beginning on or after June 30, 2008 (calendar year 2009), then refer to the section "Partnerships owned more than 90% by unitary partners".

86 IAC § 100.3380(d)(3) allows a partner's shares of business income and apportionment factors to be included in a UBG with the partnership if the following occur:

- the partnership is itself a partner in a second partnership and one of its partners is engaged in a unitary business with the second partnership, and;
- the partner and partnership are not required to use differing apportionment formulas (86 IAC § 100.3380(d)(3)(A))under IITA § 304, or;
- the partner is to be excluded under the 80/20 provisions(86 IAC § 100.3380(d)(3)(B)).

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That partner shall include in its business income and apportionment factors its share of the partnership's share of the second partnerships business income and apportionment factors.

This provision became effective for tax years beginning on or after June 20, 2002. 86 IAC § 100.3380(a) provides the following:

For tax years beginning prior to the effective date of the rulemaking adopting a method of apportioning business income, the Department will not require a taxpayer to adopt that method; provided, however, if any taxpayer has used that method for any such tax year, the taxpayer must continue to use that method that tax year. Moreover, a taxpayer may file a petition under 86 IAC § 100.3390 of this Part to use a method of apportionment prescribed in this Section for any open tax year beginning prior to the effective date of the rulemaking adopting that method, and such petition shall be granted in the absence of facts showing that such method will not fairly represent the extent of a person's business activity in Illinois.

Therefore if the original returns filed by the taxpayer for tax years beginning prior to June 20, 2002 reported the flow up of the business income and factors from a second-tiered partnership, then no petition is required to apply revised 86 IAC §100.3380(d) retroactively. However the auditor must determine that the taxpayer followed the examples in 86 IAC § 100.3380(d)(4) because it's possible for the taxpayer to use a unitary method that is not identical to the method prescribed in 86 IAC § 100.3380(d), which is not allowed unless the taxpayer received a PLR authorizing an alternative apportionment method.

If the taxpayer did not apply the method described in new subsection (d) to a tax year beginning before June 20, 2002, and now wants to use that method, a petition must be filed with Legal Services requesting permission to do so, which will ordinarily be granted if the year is in statute. If the taxpayer wants to file for permission to use revised 86 IAC §100.3380(d) retroactively, then the taxpayer should give the auditor a signed letter requesting permission to apply revised 86 IAC 100.3380(d) retroactively along with any amended returns for years that are in statute. The auditor should then submit the request to technical support. See Chapter 27 of Audit Manual for more information on Section 304(f) relief.

The following comprehensive example best illustrates how the taxpayer should file. Note that this example will also apply to a publically-traded partnership.

E. EXAMPLE – OLD RULES - UNITARY MULTI-TIER PARTNERSHIP

Here is an example of the actual mechanics involved in reporting the incomes and factors from a unitary partnership and lower tiered partnerships that are not unitary. The example is as follows:

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Corporation owns a 40% general partnership interest in partnership A. Partnership A owns a 40% interest in each of partnership B and partnership C. Partnership A's income consists entirely of interest income and its shares of the incomes of B & C. Partnership A has no payroll or tangible property. A unitary relationship exists between Corporation and partnerships A, B, and C.

The Corporation and A are required to be unitized on the corporation's separate or combined Form IL-1120. Included in the Corporation's business income will be the Corporation's 40% share of A's interest income, Corporation's factor will include its apportionable 40% share of A's Illinois and everywhere receipts, property and payroll. Since A has no property or payroll, only the 40% share of A's receipts factor will be included in the Corporation's factors. No portion of B's and C's factors will be reported on the Corporation's IL-1120 and no portion of their business income will be included in its business income.

Partnership B & C must determine the fraction of their business income which is apportionable to Illinois using their own factors. Partnership A must then include its partnership share, or 40%, of the Illinois portion of the income of B & C in its Illinois net income. Corporation must then include its 40% share of A's shares of the business income apportioned to Illinois by B & C in its Illinois net income. Corporation would report its Illinois portion of the incomes of B & C by (i) subtracting its 40% share of A's share of the business incomes of B & C from its base income as "Non-unitary partnership business income (loss)" on Line 2b of Part III of its 1997 IL-1120 and (ii) adding its 40% share of A's share of the Illinois portion of the business incomes of B & C as "Non-unitary partnership business income (loss) apportionable Illinois" on Line 10 of Part III of its 1997 Form IL-1120.

F. IL-1065 Return and Audit

In the case of a partnership that is owned less than 90% by the unitary partner or the unitary group that the partner is a member of, then the partnership will not be included on the Schedule UB and its IL-1065 will not share in the income and everywhere factors of the unitary partner. The IL-1065 will continue to be filed on a separate basis and only the income and factors of the partnership will flow up to the unitary partner. Since the IL-1065 is on a separate, non-unitary basis, there are no sales eliminations shown on the IL-1065. Only the sales that flow-up to the unitary partner are eliminated.

Example

For calendar year 2009 Corporation A and Corporation B are unrelated oil companies. Each corporation (partner) owns a 50% interest in Partnership P, an oil refinery. Partnership P is unitary with Partner A (Corp A), but not Partner B

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(Corp B). Partner A sells $500 million in crude oil to Partnership P ($100 million destination Illinois) to be processed into gasoline. Partnership P then sells $750 million ($100 million destination Illinois) in gasoline back to Partner A and $500 million in gasoline to Partner B. Partner A has total sales everywhere on line 1 of its federal Form 1120 of $1 billion ($200 million in Illinois) and Partnership P has $2 billion sales everywhere on its federal Form 1065 ($300 million in Illinois). Partner B has sales of $1 billion on its federal Form 1120 (None in Illinois) and makes $100 million in crude oil sales to Partnership P. Assume each company has base income of $100 million.

Partnership P files its IL-1065 as follows:

IL-1065	2009
Unmodified base income	100,000,000
Income distributed to partners subject to replacement tax	-100,000,000
Base Income	0
Sales everywhere	2,000,000,000
Illinois sales	300,000,000
Illinois sales factor	0.1500
++++++++++	
Net income subject to RT tax	0

Partnership P checks the box on its IL-1065, Step 1, Line G indicating that it is a member of a unitary group and writes Partner A's federal ID number in the box indicating that Partner A is the UB filer.

Note: Since unitary Partner A owns 90% or less of Partnership P, the IL-1065 is filed on a separate basis; no income or factors flow down to the IL-1065 from unitary Partner A. The sales factor on the IL-1065 is NOT reduced by intercompany sales because that would distort the Illinois partnership income distributed to non-unitary partners, as in this case Partner B.

Partnership P then sends both partners A and B a Schedule K-1-P indicating each partner's share of the federal taxable income in Column A, and in Column B reports the Illinois portion of that income. In the example Partnership P indicates on each K-1-P,

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Step 4, Column A each partner's share of total federal income, which is $50,000,000 ($100,000,000 x 50%) and in Column B shows the amount allocated to Illinois, which is $7,500,000 ($50,000,000 x 15%).

Since the K-1-P does not show any sales figures, Partnership P will have to send unitary Partner A a separate schedule indicating total sales, intercompany sales with Partner A, and Illinois sales net of eliminations. That schedule will show the following amounts:

	Everywhere	Illinois
Total Sales everywhere and Illinois	2,000,000,000	300,000,000
Less 100% of sales to Partner A	-750,000,000	-100,000,000
Sales net of intercompany	1,250,000,000	200,000,000
Partner A's ownership percentage	50.00%	50.00%
Sales flow-through to Partner A	625,000,000	100,000,000

The year-end sales flow up from the partnership to the unitary partner is 100% of the partnership's sales as reported on the federal Form 1065 less 100% of sales made by the partnership to any unitary partners times unitary partner's ownership percentage. The unitary partner then includes these sales amounts on its IL-1120.

G. IL-1120 FILERS

Continuing the above example Partner A and Partner B each reported Illinois base income (net of modifications but before apportionment) of $100,000,000. This already includes Partner A and Partner B's 50% share of Partnership P's unmodified taxable income. A's federal Form 1120 line 1 sales are $1 billion, which includes $200 million in Illinois sales. This includes $500 million in crude oil sales made to Partnership P, including $100 million Illinois sales to P. Non-unitary Partner B also reported line 1 sales of $1 billion on its federal Form 1120. Partners A and B complete their IL-1120's as follows:

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	Partner A	Partner B
IL-1120	2012	2012
Base Income	100,000,000	100,000,000
Less Non-unitary partnership income	0	50,000,000
Base income subject to apportionment	100,000,000	50,000,000
Sales everywhere per federal 1120	1,000,000,000	1,000,000,000
Add sales flow-through from P	625,000,000	0
Less 100% of Partner A's sales to P	-500,000,000	0
Total sales everywhere on IL-1120	1,125,000,000	1,000,000,000
Illinois sales	200,000,000	0
Add IL sales flow-through from P	100,000,000	0
Less 100% of IL sales to P	-100,000,000	0
Total IL sales on IL-1120	200,000,000	0
Illinois sales percentage	0.1778	0
Illinois net income	17,777,778	0

Partnership P is unitary with Partner A, but not Partner B. Partner A includes it's 50% share of Partnership P's total sales and P's Illinois sales, net of intercompany eliminations, in with its own sales on the IL-1120. Since Partner A made $500 million in crude oil sales to Partnership P ($100 million in Illinois), it reduces its sales factor by 100% of these sales.

Since Partner B is not unitary with Partnership P, its 50% share of P's income is reported as non-unitary partnership income. None of the factors of partnership P flow up to Partner B's IL-1120; nor is there any sales elimination between B and P. On its 2009 IL-1120, Step 4, Line 35 Partner B reports its non-unitary share of Illinois income from Partnership P of $7,500,000 (($100,000,000 x 15%) x 50%).

H. 80/20 PARTNERSHIPS OR PARTNERS

If either the partnership or the partner is an 80/20 company, then the unitary rules under 86 IAC § 100.3380(d) do not apply. In that case an Illinois partnership will file an IL-1065 on a separate basis, and the corporate partner will report the partnership's income or loss as non-unitary.

> Note: In determining if the partnership is an 80/20 company, only the property and payroll of the partnership is considered, if it's a three-factor company. No factors of the partners will be included in the 80/20 test.

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In addition, the partnership cannot be included in a unitary group if the partnership and the partner apportion their income under different apportionment formulas under IITA § 304. Ref: 86 IAC § 100.3380(d)(3)(A).

I. PARTNERSHIPS OWNING CORPORATIONS

Occasionally a partnership will own one or more corporations. In the first paragraph of 86 IAC § 100.3380(d)(1) partnerships may be members of unitary business groups and, if a member, will have to use combined apportionment. That subsection then creates an exception to the combined apportionment requirement in the case of a partnership that is unitary with one of its partners. A partnership must use unitary apportionment if it owns one or more corporations and is in a unitary business with them.

In that situation, the group will have to complete a Schedule UB that includes the partnership, and follow the Schedule UB form instructions for a unitary group that includes an S corporation. The Schedule UB Instructions were updated in 2013 to include detailed instructions on how a partnership would file its return if a member of a unitary business group.

86 IAC § 100.9700(b) was amended effective June 30, 2008 to allow non-corporations to be members of the unitary group. That change is retroactive, but taxpayers may have a valid claim under the Taxpayer's Bill of Rights that no deficiency can be assessed for prior years.

J. UNITARY GROUPS COMPRISED ONLY OF PARTNERSHIPS

A unitary group can be composed only of partnerships It was only the prohibition in 86IAC §100.9700(b) that limited unitary groups to corporations that prevented partnerships from forming their own unitary group. 86 IAC §100.9700(b) has since been amended to allow unitary groups composed of non-corporations. The change is not based on a statute change, so it is effective for all years.

The filing will be undertaken with one Schedule UB (unless there are partnerships with different taxable years, in which case a separate Schedule UB will need to be prepared for each taxable year),and each partnership filing an individual IL-1065 with the Schedule UB attached.

K. SCHEDULE AUB II

Unitary partnerships will be processed using the supplemental schedule AUB II.

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XII. HOLDING COMPANIES

A holding company is generally formed to hold the stock, assets or liabilities of another corporation or other corporations. Holding companies can appear in any tier of a corporate structure and can perform a large variety of functions or virtually no functions at all.

A holding company with no assets or employees can be unitary with its subsidiaries as long as the subsidiaries control the operations of the holding company. It is not necessary for functional integration to exist in the normal manner when one of the companies is a shell company. Ref: Consol, Inc. v. Glen Bower, Cook County Circuit Court, No. 01 L 51196 (2003).

The unitary combined apportionment law in Illinois generally provides for the unitization of whole corporations. To the extent that a taxpayer or the Department would attempt to unitize a whole corporation or group of corporations with a portion of another corporation, either the requirements of 86 IAC § 100.3010(b) of the regulations pertaining to discrete businesses within a single corporation would have to be met or IITA § 304(f) relief would have to be granted.

One common example of the application of the discrete business rule arises when unitizing holding companies. If a holding company is unitary with two or more unitary business groups that are not unitary with each other, a portion of the holding company's net income or loss and factors should be allocated to each of the unitary business groups. IITA § 1501(a)(27)(B) provides not only for the inclusion of a holding company within a unitary group under subsections of IITA § 304, but the splitting of the holding group in a pro rata basis with more than one group when members of the group fall into the different subsections of IITA §304 (a)-(d). However, this principle would apply when there are two three-factor groups that are not unitary with each other because they are engaged in discreet businesses.

For information regarding the unitary determination for Holding Companies, refer to Audit Manual Chapter 29.

XIII. OIL AND GAS INDUSTRY

Companies operating in the oil and gas sector are predominantly involved in vertically integrated processes (a hallmark of unitary relationships). This portion of our discussion will concentrate on the oil and gas segment of the business and discuss the relative audit issues which are most commonly encountered in the audits of oil companies. A listing of terms which are commonly used in the oil and gas industry and their definitions may be accessed in Chapter 47 of the Audit Manual.

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While the oil and gas industry is predominantly engaged in steps in a vertical process, during the last few decades the major oil companies have diversified into businesses which were not traditionally associated with the oil sector. For example, some of the oil companies are engaged in agriculture and meat packing, manufacture of electronic parts, packaging materials and containers, real estate development, food marts, underwriting life & casualty risks, etc. However, a typical oil and gas company would normally be engaged, either through its divisions or subsidiaries, in the following businesses or operations:

1. Exploration and Production.
2. Refining and marketing.
3. Transportation of oil, gas and feedstock. For example, pipeline companies, marine transportation companies, etc.
4. Chemical products and by-products.
5. Research and development of related products, processes and methods.
6. Motor club operations.
7. Credit card operations.

In addition to the above, an oil company will typically have a credit corporation as a subsidiary which will cater to the group's financial needs, and more specifically, finance the marketing of gasoline. It may also have subsidiaries engaged in coal and metal mining.

As in any audit, alterations that are made to the unitary business group (particularly in respect to pipeline and/or credit subsidiaries) must be supported by as many facts as possible relating to the actual operations and the interrelationships of the companies involved.

> Note: For years prior to tax years ending 12/31/2000 oil and gas companies were subject to the three factor apportionment regimen. For a discussion of specific issues pertaining to the oil and gas company property and payroll factors (for audits prior to the tax years ending 12/31/00, or applicable Section 304(f) situations) see the Historical Extracts and Exhibits section. A more comprehensive discussion of the property and payroll factors at large can be found in Audit Manual Chapter 27.

A. Partnerships and Joint Ventures

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It is not unusual for a production and exploration subsidiary of an oil company to conduct its activities through partnerships, joint ventures or joint operating agreements with other oil companies. There are, basically, three types of agreements which oil and gas companies become involved in:

1. General and/or limited formal partnerships
2. Joint ventures
3. Joint operating agreements

IITA § 1501(a)(16) provides the definition of partnership and parallels the IRC § 761(a) definition of a partnership. A partnership may be considered a syndicate, group, pool, joint venture or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on. It is not considered to be a trust, estate or a corporation.

The related IRC regulations specify that a simple, joint undertaking, in which expenses are shared or in which there is a mere co-ownership of property does not constitute a partnership. Tenants in common may be partners "if they actually carry on a trade, business, financial operation or venture and divide the profits thereof." REF: IRC § 1.761-1(a).

A discussion of partnerships and the oil and gas industry can be found in ARTHUR YOUNG'S OIL AND GAS, Federal Income Taxation, 1988 Edition, chapter 26. The following is an excerpt from that chapter.

> The hallmarks thus laid down by the Code and regulations are broad enough to encompass most, if not all, of the forms of joint operation of properties in use in the oil and gas production industry, including not only formal partnerships, general or limited, but also joint ventures and, subject to the exception provided on the making of timely elections, co-owners operating through joint operating agreements. It would appear that the latter-i.e., joint operating agreements-are included even though the participants have reserved the right to take their respective shares of production in kind or to dispose separately of such shares. Even though it can be said that by reason of such terms such organizations do not have a joint profit objective, they must, under the partnership regulations, be deemed to have made or make timely elections to be excluded from the partnership provisions of the Code [and from the requirement of filing federal Forms 1065]...

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A joint operating agreement that contains a "take-in-kind" clause may still have a joint profit objective, and therefore, have the necessary business purpose to qualify as a partnership. This position is supported by the case of Madison Gas and Electric Company case, 72 TC 521 (1979). In that case, the Tax Court found that a valid partnership may exist for federal income tax purposes even though a joint operating agreement contained a take-in-kind provision.

> A synopsis of the Madison Gas and Electric Company case can be found in the audit manual chapter 49.

Formal partnerships, general and limited, are subject to the provisions of Subchapter K of the Internal Revenue Code. They are required to file federal Forms 1065. A limited partnership is used to a greater extent in the oil and gas industry than a general partnership since it provides a way to attract financing from a large number of investors in return for a limited liability for the partnership's debts. The IRC also contains some beneficial provisions to limited partners regarding intangible drilling costs. In comparison, general partnerships have the disadvantage of unlimited liability for partnership debts.

Joint ventures and joint operating agreements are, essentially, informal partnership arrangements. They are also subject to the provisions of Subchapter K, however, they can, if they meet certain qualifications, elect to be excluded from the provisions. If this election is made, they are not partnerships for Illinois purposes. See 86 IAC § 100.9750(d)(1)(B) .

To qualify for the exclusion election, the organization must be for:

1. Investment purposes only and not for the active conduct of a trade or business; or

2. The joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted; or

3. Dealers in securities for a short period of time for the purpose of underwriting, selling or distributing a particular issue of securities. REF: IRC Section 761(a)

The second qualification was added to the Code specifically to cover the joint operation of oil and gas producing properties through so-called joint operating agreements.

IRC § 761(a) also requires that the members must be able to compute their separate shares of income without the necessity of computing the taxable income of the partnership.

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B. Rules Governing the Treatment of Partnership Income

The operations of oil and gas partnership operations are, generally, steps in the vertical integration of an oil company. Therefore, the corporate partner's share of the partnership's income and factors are unitary and should be accounted for using 86 IAC § 100.3380(d). The unitary nature of the operations cannot simply be ASSUMED however. The nature of these partnerships and their relationship with the corporate partner must be examined and documented in the audit file.

The income from an oil and gas partnership is not excluded from 86 IAC § 100.3380(d) treatment simply because it is limited in nature. If the limited partner is operationally involved in the partnership and the other limitations of 86 IAC § 100.3380(d) do not apply, the partner's pro rata share of the income and factors can be included in the partner's return.

If the operations of the partnership and the corporate partner are not unitary or the limitations prohibiting the use of 86 IAC §100.3380(c) apply, IITA § 305 would govern the allocation of the partnership income. Refer to IITA §305, 86 IAC §100.3380(d) and the Partnership Income section of the Audit Manual Chapter 28 for additional information on the treatment of partnership income.

C. THE OUTER CONTINENTAL SHELF (OCS)

The Outer Continental Shelf Lands Act extended the jurisdiction of the United States to property located beyond the 3-mile state jurisdictional limit to the area of the ocean where the outer continental shelf ends. The federal jurisdiction in the area extends to all artificial islands and fixed structures erected on the shelf. The states are prohibited from imposing taxes, either directly or indirectly, on the revenues derived from areas under federal jurisdiction, such as the OCS.

Taxpayers have contended that since the states are prohibited, by federal statute, from taxing the revenues from the OCS, those revenues should be excluded from the tax base. They further felt that the property, payroll and revenues from these activities should be excluded from the apportionment formula computations. The states, on the other hand, have taken the position that OCS activities are includable in both the tax base and in the denominators of the apportionment formula factors.

On November 8, 1988 the Supreme Court held, in the case of Shell Oil Company vs. Iowa Department of Revenue, 488 U.S. 19 (1988) that the Federal preemption is

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"exclusively concerned with preventing the adjacent states from asserting, on the basis of territorial claims, jurisdiction to assess direct taxes on the Outer Continental Shelf...This is a far cry from prohibiting a State from including income from OCS-derived oil and gas in a constitutionally permissible apportionment scheme."

The Court further held that the inclusion of earnings derived from these offshore drilling operations were includable in a state's pre-apportioned tax base:

> It is irrelevant for the makeup of the apportionment formula's unitary tax base that third party sales occur outside of the State...Actual sales on the OCS (as opposed to internal accounting sales) are not taxed directly by any State because they are not included in the numerator of the sales ratio...From the inclusion of such sales in the apportionment formula's tax base, it does not follow that the dollar amount derived from the formula (which is a fraction of the unitary tax base) includes income not fairly attributable to Iowa.

When dealing with offshore drilling operations then, earnings from any activities occurring on the OCS should be included in the tax base and any property, payroll and sales should be included in the everywhere factors of the apportionment formula. Oil in transit from this area should be included in the destination state's property factor numerator. Sales taking place on the OCS would not be included in any state's sales factor numerator, however any oil that is piped out or hauled out of the OCS area by the driller and subsequently sold can be allocated to the destination state for sales factor purposes.

The Florida Supreme Court in the case of Shell Oil Company vs. Department of Revenue, State of Florida, also upheld the position that revenues from offshore drilling operations could be included in business income. Refer to Chapter 49 (new) for synopses and the complete case citations of the Shell Oil Company cases.

XIV. UNITARY PROCESSING ISSUES

If the audit results in affiliated companies being separated into multiple unitary groups, then multiple audits should be prepared.

The IDR-229-UB will be submitted at the beginning of the audit. Each audit will be transmitted on a separate track number, as generated by Gentax. The audits must also contain separate PROD-1s. However, the tracked documents must be kept together when transmitted to Technical Review. A note requesting that the cases be kept together should be attached to

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the outside of the files and each audit should contain cross-references to the other track numbers involved.

The Audit Planning Section should be contacted to obtain the additional track assignment(s).

Note: For tax years ending on or after December 31, 1993, any Illinois filer who is a member of a unitary business group MUST file a combined return for Illinois.

A. Original Returns Filed on a Separate Company Basis

If original returns were filed on a separate company basis and the audit determines that the taxpayers are members of a unitary group, do the following:

- One combined Auditor's Report (EDA-25) should be prepared under the designated agent's name and FEIN.
- The UB-229 should be completed and signed by the taxpayer.
- The as-filed figures from each member's GenTax account should be totaled and entered in Column A. Column C should reflect the combined audit adjustments.

Note: Column A obviously will not match the GenTax information for any one of the members. Also, it will not be necessary to "zero out" the returns of the members who are being combined with the designated agent. When the audit is processed, the original returns of those members will be transferred by Audit Perfection.

The as-filed combined factor for EDA-25 Column A purposes is determined by dividing Illinois business income by Apportionable Business Income.

B. Audit adds and/or deletes members

(1) **Adding Member(s) -** One combined Auditor's Report (EDA-25) should be prepared. Column A should reflect the original combined return figures plus the as-filed figures for the added member(s). Column C should reflect the combined audit adjustments.

(2) **Deleting member(s)** – The combined EDA-25 should reflect the as-filed figures of the combined return in Column A. Column C should reflect the combined audit adjustments with the deleted member's figures removed.

The deleted member or members should have their liability established on an EDA-25 and a signed IL-870 should be obtained.

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- If the deleted member is a loss company, the Auditor should prepare an IL-1120-X and obtain the taxpayer's signature. Column A on both the EDA-25 and the IL-1120-X should reflect zeros. However, the company will retain the combined return's filing date, statute, etc. In the comment section on both the EDA-25 and the IL-1120-X, it should be noted that this taxpayer was included in the original unitary combined return for FEIN: XX-XXXXXXX. In both cases, the audit should be closed with its own track, audit report, workpapers, PROD-1, etc.

- If the deleted companies are members of their own unitary group, a designated agent should be selected and the EDA-25 or IL-1120-X should be completed on a combined basis.

C. Audit both adds and deletes member(s)

If members are both added and deleted from the combined return, the EDA-25 will still be completed on a combined basis with the as-filed figures of the combined return and the added members totaled in Column A and the combined audit figures in Column C.

D. No Liability APE's/ IL Filer(s) within a Separate Filing UBG

- If there are no line changes to the returns as filed, EDA-25s are not needed for no liability audits (NL) of Illinois filers who are members of a unitary group filing separate unitary returns.

- If during the course of an audit which results in a liability, it is determined that there are NL years (APEs) for a company (or companies), whether separate apportionment, separate unitary or combined Illinois returns have been filed, an EDA-25 does not need to be prepared if there are no line changes involved.

- If there are audit adjustments, which result in line changes but in no additional liability, and the taxpayer agrees with the changes, the auditor should secure a signed IL-1120-X detailing these changes. This is the only manner in which a taxpayer is bound to an agreement of the specific audit findings.

    - A signed IL-870 does not serve the same purpose as a signed IL-1120-X in a NL situation. By signing the IL-870, the taxpayer is agreeing only to an increase or decrease in tax liability, not to the specific line changes. The IL-1120-X will be processed into GenTax and the audit adjustments will be finalized.

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- If, however, there are audit adjustments, which result in line changes but in no additional liability and the taxpayer does not agree with the changes, EDA-25s should be prepared to reflect the line changes.
    - Usually these audits involve Illinois net losses, which may be carried forward to offset liabilities in later years. The taxpayer will have the ability to disagree with the adjustments to the loss year when the loss is carried forward and a liability or overpayment is established. Although the line changes in this situation are not finalized, they will be entered into GenTax for future use.

E. Un-agreed Audits

1. Separate original returns determined to be unitary

When returns are filed on a separate company basis and the audit determines that the taxpayers are members of a unitary group:

one combined Auditor's Report (EDA-25) should be prepared as detailed under tax years on or after 12/31/93, Agreed Audits. The Notice of Deficiency (NOD) will be based on the combined EDA-25 and issued to each company which is included in the combined return.

2. Combined return filed. Audit adds/or deletes member(s)

The EDA-25 should be prepared as detailed under Tax Years on or after 12/31/93, Agreed Audits, in each situation for agreed audits. In the case of added members, the NOD will be issued to the designated agent and the added member(s).

In the case of deleted member(s), the NOD will be issued to the designated agent. A separate NOD will be issued to the deleted member(s) establishing their separate company liability.

3. EDA-27 Explanation of Adjustments

Adjustments combining separate companies or adding them to the combined return will not be reflected on the EDA-27 because Illinois business income changes are not captured. Only the changes made for the other issues appear in Column B and flow through to the EDA-27.

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XV. Application of the EDA-25

Note: Verifying Col A of the EDA-25 is discussed in Audit Manual Chapter 20 under the section, "Reviewing Tax Returns For Column A Determination". Specific applications for completing the EDA-25 are discussed in Audit Manual Chapter 20 under the section, "Documentation Needed in Completing an Audit".

For information regarding restricted interest, refer to Chapter 42.

A. Obtaining the Figures for Column A of the EDA-25

1. UB Spreadsheets 2010 09-09-14

Note: For the years 2010 and forward, the schedule UB is found within the return in Gentax, attached as part of the return.
For the years 2009 and prior, the schedule UB is found separately from the return within Gentax. There are two separate macros which reflect this difference. Use care when selecting the appropriate macro to use the spread sheet which will be imported from Gentax.

In Gentax: select the business accounts, returns, and the return year and the schedule UB from within the year of audit. Select the export button, and select the export to Excel button.

Before using the macro workbook, the information needs to have been exported from Gentax using the "Export to Excel" option and saved as an Excel workbook.

On the macro worksheet, select the Schedule UB.

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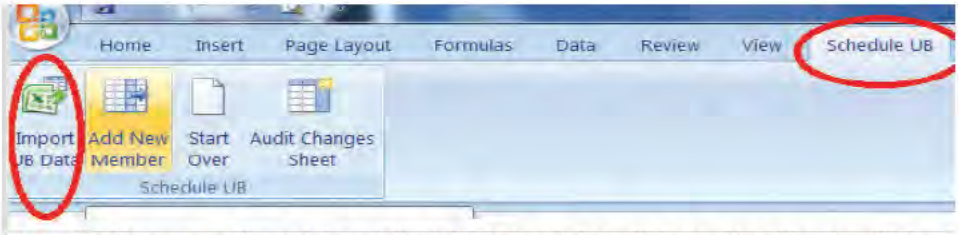

Four buttons on the Schedule UB tab of the ribbon (toolbar) will be present.

1. The "Import UB Data" button runs a macro that imports UB data from the file that was exported from Gentax, and saved as an Excel workbook.

2. The "Add New Member" button runs a macro that adds one additional column (if the last used "Per Audit" worksheet column contains entries)

3. The "Start Over" button runs a macro that deletes everything but the instructions worksheet.

4. The "Audit Changes Sheet" button runs a macro that adds two additional worksheets: "Audit Changes" and "Adjusted UBG".

    - Audit Changes worksheet summarizes the audit changes made on the "Per Audit" worksheet. It will be used to enter the audit changes into Gentax.

    - Adjusted UBG worksheet reflects the UBG after the audit changes.

Specific instructions for working with the worksheets are contained in the instruction page for the macro for the fill in fields (shaded light blue).

2. <u>UB Spreadsheets 2009 09-09-14</u>

Note: For the years 2009 and prior, the schedule UB is found separately from the return within Gentax. For the years 2010 and forward the schedule UB is found within the return on Gentax. There are two separate macros which reflect this difference. Use care when selecting the appropriate macro to use the spread sheet which will be imported from Gentax.

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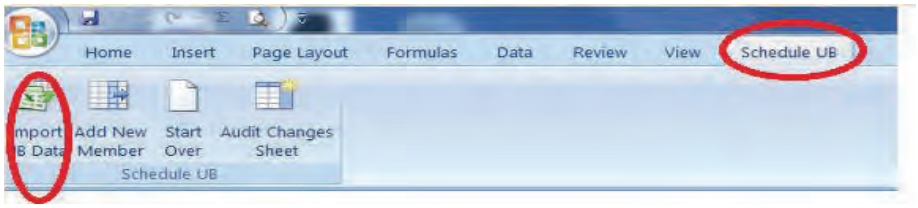
In Gentax: select the business accounts, returns, and the schedule UB for the year of audit. Select the export button, and select the export to Excel button.

Before using the macro workbook, the information needs to have been exported from Gentax using the “Export to Excel” option and saved as an Excel workbook.

[redacted]

On the Macro for the 2009 or prior year, select Schedule UB button. There are four buttons on the “Schedule UB” tab in the upper left corner.



1. The “Import UB Data” button runs a macro that imports UB data from the file that was exported from Gentax, and saved as an Excel workbook.

2. The “Add New Member” button runs a macro that adds one additional column (if the last used “Per Audit” worksheet column contains entries)

3. The “Start Over” button runs a macro that deletes everything but the instructions worksheet.

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4. The "Audit Changes Sheet" button runs a macro that adds two additional worksheets: "Audit Changes" and "Adjusted UBG".

    - Audit Changes worksheet summarizes the audit changes made on the "Per Audit" worksheet. It will be used to enter the audit changes into Gentax.
    - Adjusted UBG worksheet reflects the UBG after the audit changes.

Specific instructions for working with the worksheets are contained in the instruction page for the macro for the fill in fields (shaded light blue).

B. Using The CXC25SUP

In The Excel Stand Alone Program To Obtain Col A Figures On The EDA-25
This supporting schedule is **required** to be used to calculate the EDA-25 "As Filed" column when the auditor is adding separate Illinois filers to a combined return or combining two or more unitary groups that did not originally file as one unitary group.

The auditor must include in the audit comments that this schedule has been prepared for the audit and a copy of this schedule must be put in the audit file immediately following the EDA-25.

Complete the CXC25SUP, the auditor should complete all of the information requested in the fill in boxes that pop up in the schedule. Once the requested information has been entered in the beginning of the schedule and the auditor can view the completed schedule, a few additional items are required to be done to complete the schedule. These changes have to be made manually on the schedule at this time.

To complete the necessary changes the auditor will need to unprotect the schedule. To do this the auditor will have to use the tool bar at top of the excel spreadsheet and click on Review and then click on Unprotect Sheet.

CXC25SUP - Supporting Schedule

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See Example of adding separate Illinois filers to a combined return on following page.

SCH XVIII — COMBINED AS-FILED CALCULATION FOR AUDITOR'S REPOI — 09/09/1999

Supporting Schedule

XX 9/9/1999 — XXX Inc — FEIN: 22-XXXXXXX

1

FEIN	22-XXXXXXX	54-XXXXXXX	59-XXXXXXX	58-XXXXXXX	52-XXXXXXX	36-XXXXXXX	
12/31/2002	parent name	sub 1 name	sub 2 name	sub 3 name	sub 4 name	sub 5 name	TOTAL TO EDA25
Federal Taxable Income	132,254,915	285,646,730	547,934	(671,547)	6,362,846	2,769,693	426,910,571
Exempt interest addback							0
Income tax addition	872,000	1,414,967	30		62,116	402	2,349,515
RT addition for IT							0
RT addback for RT							0
NOL addition							0
Bonus Depreciation							0
Other	77,681			1,673,285	106,625		1,857,571
(Replace w/description)							0
US govt interest subt'n							0
Section 78/Subpart F divd							0
Foreign dividends (Sch J)							0
Illinois Depreciation							0
Other	347,280	117,029		210,272	13,531		688,112
(Replace w/description)							0
Base/UB income							430,429,545
Nonbusiness income	4,174,319		93,679				4,267,998
Partnership income		9,862,887					9,862,887
Apportionable business inc							416,298,660
Everywhere sales	965,135,023	687,640,111	9,169,980	223,771,092	9,295,479	10,443,688	1,905,455,373
Illinois sales	41,270,046	0	1,366	65,665,666	1,795,684	249,075	108,981,837
Apportionment factor							0.016948
Illinois business income	5,502,614	0	68	232,250	1,259,145	66,064	7,060,141
Illinois nonbusiness income							0
Illinois partnership income		(4,909)					(4,909)
Illinois NLD (+)							0
Income tax credits				11,134			11,134
Replcmnt Tax paid Cr (IT)	273			82	292	2	649
Replcmnt Tax Cr C/F (IT)							0
RT investment credit							0
IT ITC recapture							0
RT ITC recapture							0
IT & RT estimated pymnts	784,358	91,000			16,922	7,654	899,934
IL-505 payments			100		97,900		98,000
Payment w/original return				13,783			13,783
Other subsequent pymnts				3,457			3,457
Pmnts applied to pen & int				1,996	36		2,032
Credit carryforward amts	382,943		95		23,160		406,198
Total refunds w/same date		31,014		1,206	14	251	32,485
Other released refunds		59,594		1,001		2,584	63,179
Type 13/14 payments		392		7,238			7,630
Total pending refunds							0
Sec 3-3(a-10) penalty asmt							0
Sec 3-3(a-10) penalty paid							0
Sec 3-3(b-10)(1) pen asmt							0
Sec 3-3(b-10)(1) pen paid							0
Other penalty assessment							0
Other penalty paid							0
Interest on UPIA penalties							0
Unpaid int on UPIA pens							0
Other interest assessmnt							0
Total Tax As-Filed	401,415	0	5	5,799	91,612	4,819	503,650

2

3

Complete the supporting schedule and add separate Illinois filers to a combined return, note that for the parent name column, enter the name of the combined group filer that the separate filers are being added to. In the subsidiary's name columns, enter the information for the separate filers that are being added to the combined return.

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Changes that are needed on this schedule when it is being completed are as follows:

1) See the above number one - in the cell above the tax year – enter FEIN and then in the same column above each filer name enter the federal identification numbers for those filers.

2) See the above number two – The auditor needs to enter the Illinois business income amount for each filer identified on the Supporting Schedule. If the audit includes one or more loss companies, the auditor must enter the word “loss” into the Illinois business income line for that taxpayer in order for the schedule to calculate correctly. The auditor can also enter the number “0”, but it gives a clearer picture when the word loss is typed in the line.

3) See the above number three – Type in “Total Tax As-Filed” over the field “Other interest paid”. This line is needed to verify that the payment information entered will crossfoot and downfoot correctly. The filer totals must sum to agree with the group total figure.

   Total Tax As-Filed per parent name column:
   784,358 - 382,943 = **401,415**

   Total Tax As-Filed per sub 1 name column:
   91,000 - (31,014+59,594+392) = **0**

   Total Tax As-Filed per sub 2 name column:
   100-95= **5**

   Total Tax As-Filed per sub 3 name column:
   (13,783+3,457) - (1,996+1,206+1,001+7,238) = **5,799**

   Total Tax As-Filed per sub 4 name column:
   (16,922+97,900) - (36+23,160+14) = **91,612**

   Total Tax As-Filed per sub 5 name column:
   7,654 - (251+2,584) = **4,819**

   Group Total
   Total Tax As-Filed per the Total Column for this schedule:
   (899,934+98,000+13,783+3,457) - (2,032+406,198+32,485+63,179+7,630) = **503,650**

   Sum of Filer Totals
   (401,415+0+5+5,799+61,612+4,819) = **503,650**

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C. Required Schedules/ Entering Lines off of the Schedule UB

The EDA-25 Supplemental (CXC25SUP) and the Schedule UB will reflect the changes when members have been either added or removed from the group. These forms must be included for processing the CXC25SUP and are required:

- when adding separate Illinois filers to a combined return, or
- when combing two or more groups that did not originally files as one unitary group.

A corrected Schedule UB must be provided when there are changes to:

- the IL-1120 Line 1 figures on the return, and
- the Sales Everywhere and to Illinois Sales on the return.

In the case of multiple EDA-25's, supporting documentation must be attached to each EDA-25 as needed.

Schedules – the following need to be attached to the EDA-25 for proper processing in GenTax:

Tax Year	Required Schedules
2007 - 2008	Schedule 1299-D and Schedule UB
2009	Schedule 1299-D, IL-4562, Schedule M, Schedule UB
2010	Schedule 1299-D, IL-4562, Schedule M, Schedule 80/20, Schedule UB
2011 - 2013	Schedule 1299-D, IL-4562, Schedule M, Schedule 80/20, Schedule INL Schedule UB
Fiscal year 2011 only	Schedule 1299-D, IL-4562, Schedule M, Schedule 80/20, Schedule INL Schedule UB, AND Schedule SA

Lines that need to be entered off of the Schedule UB for members being added, deleted or changed are as follows:

Step 2, Line 28
Step 2, Line 29a
Step 2, Line 29b
Step 4, Line 2
Step 4, Line 3
Step 4, Line 6
Step 4, Line 7
Step 4, Line 9

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For a more detailed discussion on specific processing notes, see the Chapter 20 discussion on Auditor Comments, conclusions, and specific processing notes.

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XVI. HISTORICAL EXTRACTS/EXHIBITS SECTION

A. Change of Designated Agent Form: IDR-229-UB

Illinois Department of Revenue

IDR-229-UB Change of Designated Agent Effective Tax Year Ending_____

Step 1: Identify your designated agent

Name of the new designated agent — FEIN of the new designated agent

Name of the current designated agent — FEIN of the current designated agent

Name of the controlling corporation (see Schedule UB general instructions) — FEIN of the controlling corporation

Step 2: Identify the contact

Contact for this schedule — Phone

Business name — FEIN

Legal address

Step 3: Identify members

	Name	FEIN
1.		
2.		
3.		
4.		
5.		
6.		
7.		
8.		

(Attach additional page(s) if needed)

Step 4: Authorization

As the eligible members of a combined return filed under designated agent_____, we hereby authorize _____ to become the new designated agent of the combined return. We also authorize the transfer of all payments of tax, penalty, interest, and any signed waivers to the new designated agent for the tax years ending _____ and forward.

Signature of authorized officer(s) — Signature of authorized officer(s)

Comments

IDR-229-UB (N-08/14)

B. UTILIZING COMPUTER ASSISTED AUDIT OPTIONS

Some type of sampling method may be required to verify the accuracy of a large number of transactions in an audit. CAA personnel can assist the auditor when dealing with such transactions.

The Audit Bureau's position is that statistical sampling is the preferred method in large case auditing. CAA techniques will be used in these instances. **The auditor should contact CAA personnel on these cases as soon as the case is assigned.**

- CAA will be able to discuss the information with the taxpayer to determine the proper way to proceed.
- CAA personnel may be able to secure the data necessary to perform the audit prior to the first audit appointment. In these instances, the auditor may walk into the taxpayer's business with reports in hand.
- If the taxpayer has a large volume of transactions or the case took a large number of hours in the prior cycle, these cases are prime targets for CAA techniques.
- Even if a statistical sample is not used in the audit, CAA should still be contacted for advice on the sampling method that the auditor may want to employ.

1. GENERAL CAA ASSISTANCE

CAA personnel can aid the auditor by:

- Assisting in obtaining data from the taxpayer
- Validating data
- Converting taxpayer files into an auditor friendly format
- Generate reports, and calculate amounts
- Make large files more manageable

2. AREAS OF POTENTIAL USE

The list below is intended to provide some potential areas that CAA may be able to assist in and how CAA deals with that area. This list is not intended to be all-inclusive, but is provided to give ideas of potential areas where CAA can benefit the audit process. This list is contained in the Standardized forms folder on the auditor's computer, under CAA-CIT Activities. The potential uses are reprinted below for reference, and on the auditor's computer.

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- US Government Interest
  - Identify file-containing data supporting subtraction. Summarize type of obligations claimed with dollar totals and record counts.

- Sales Factor Calculations
  - Obtain file containing sales transactions summarized in order necessary to identify the proper calculation of the factor. Summarize data in file and provide correct amounts for the factor.

- Bonus Depreciation
  - Convert files and process data. Calculate Illinois Depreciation amounts.

- IL-1023-C Partnership Test
  - Review of 1023-C filers for accuracy based on information pulled from Gentax. This is also useful in reviewing S-Corp shareholders for non-filing of Illinois returns. List of shareholders SSN's can be matched against IDOR income tax files to identify missing periods.

- Filer Verification
  - Review of companies listed on federal Form 851, federal Form 7004 or other source to verify who is on GenTax as a filer. This is useful in verifying that we do not miss a company for waiver purposes. Also may be able to use as a replacement for the AUB schedule.

- Consolidated Group File
  - File may be in Excel, for example. Such a file should contain all consolidating information for all members of the Federal consolidated group. This should allow for assistance and speed in determining the impact of adding or removing companies from unitary groupings.

3. PRIOR AUDIT THAT UTILIZED CAA ASSISTANCE

The CAA staff needs to be contacted if the prior audit utilized CAA, and the auditor is considering using the prior audit results in the current audit. It will be necessary to obtain the taxpayer's computer records to recreate the same populations that were used in the prior CAA samples.

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- CAA will provide reports to ensure that any changes in locations, cost centers or accounts can be addressed. If any new changes exist from the prior audit, separate audit procedures may need to be utilized depending upon their significance.

- CAA will recreate the population that was utilized in the prior cycle. The newly created population will be stratified on the same basis as the prior cycle. This should be compared to the stratification report from the prior audit to determine if any significant changes exist between the two periods.

a) Management Approval

It is mandatory that Management participates in any decision-making on cases utilizing prior audit results. Approval of the audit supervisor is required and must be documented.

After an error rate projection is made based on the prior audit results, any subsequent audit periods may only be projected with the written approval of the Assistant Division Manager. Only AGREED audits can be processed when this method is used.

4. CAA REQUEST FORM

To request CAA assistance, the auditor should complete and submit the form – "Request for Services of Computer Assisted Audit Group". This form is found in the CAA folder within the Standardized Forms folder on the auditor's computer/laptop.

C. UNITARY APPORTIONMENT CASE LAW

A large number of unitary apportionment cases have been decided by state courts (especially California) and the US Supreme Court throughout the years. Some of the cases of major importance are cited below in order of relevancy, with a brief synopsis. A review of these cases will give an understanding of how the unitary apportionment method has developed over time and how the courts have reacted to its application and interpretation by the states. A synopsis of these and other important court cases may be found in the Audit Manual Chapter 49.

U.S. Supreme Court

Exxon Corp. v. Wisconsin Department of Revenue, 447 U.S. 207 (1980) (functional departments were not discrete business enterprises nor does Due Process Clause

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require income to be allocated to various states through separate accounting if feasible; income was part of unitary business and subject to fair apportionment among all states having sufficient nexus).

Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980) (unitary relationship between corporation and foreign affiliates provided sufficient basis for including foreign dividends in apportionable income).

ASARCO, Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982) (intangible income from foreign operations could not be included in apportionable income absent a unitary relationship; subsidiaries were discrete business enterprises unrelated to parent's in-state activities).

F.W. Woolworth Co. v. Taxation & Revenue Department of New Mexico, 458 U.S. 354 (1982) (parent with complete ownership had potential to operate companies as integrated divisions of a single unitary business; absent showing of actual integration of business activities or centralization of management, subsidiaries were not part of a unitary business).

Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983) (must be more than occasional oversight in a distinct investment; flow of value must exist between in-state and out-of-state activities).

MeadWestvaco Corp. v. Illinois Department of Revenue, 553 U.S. 16 (2008) (operational function test not intended to serve as a separate basis of apportionment; finding that an asset serves an operational function supports the conclusion that it was a unitary part of the business conducted in the taxing state; where the asset in question is another business, the traditional hallmarks of a unitary relationship—functional integration, centralized management and economies of scale—must be shown).

Other Federal Courts

In re: Envirodyne Industries, Inc., 354 F. 3d 646 (7th Cir. 2004) (subsidiaries must depend upon and contribute to each other; dependence on common parent insufficient).

Illinois Courts

Caterpillar Tractor Co. v. Lenckos, 84 Ill. 2d 102 (Ill. Sup. Ct. 1981) (finding overall design of IITA § 304 is to determine amount of business income fairly attributable to Illinois).

Citizens Utilities Co. v. Department of Revenue, 111 Ill. 2d 32 (Ill. Sup. Ct. 1986) (must be more than mere flow of funds).

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Miami Corp. v. Illinois Department of Revenue, 212 Ill. App. 3d 702 (1st Dist. App. Ct. 1991) (alternative apportionment).

A.B. Dick Co. v. McGaw, 287 Ill. App. 3d 230 (4th Dist. App. Ct. 1997) (functional integration and strong centralized management not separate tests).

Borden, Inc. v. Illinois Department of Revenue, 295 Ill. App. 3d 1001 (1st Dist. App. Ct. 1998) (control over financing, tax compliance and at least some aspects of purchasing, personnel and marketing demonstrated functional integration).

Hormel Foods Corp. v. Zehnder, 316 Ill. App. 3d 1200 (1st Dist. App. Ct. 2000) (flow of knowledge, significant level of control by parent over subsidiaries, and centralization of a number or corporate services sufficient to show unitary relationship).

Zebra Technologies Corp. v. Topinka, 344 Ill. App. 3d 474 (1st Dist. App. Ct. 2003) ((a) taxpayer failed to demonstrate percentage of activities conducted within and without the United States was sufficient to exclude subsidiaries from unitary group based on 80/20 test; (b) only portion of investment portfolio income that was used as working capital for corporate acquisitions could be included in apportionable income).

Dow Chemical Co. vs. Department of Revenue, 359 Ill. App. 3d 1 (1st Dist. App. Ct. 2003) ((a) similarity of business activities is sufficient to satisfy same general line of business requirement; (b) significant direct sales from parent to subsidiary is evidence of vertically structured enterprise or process; (c) evidence that companies dealt extensively with each other is not sufficient for a unitary business finding absent functional integration and centralized management; (d) during the post transition years, parent's oversight in the form of receiving reports is indicative of an investment relationship and not integration of business activities; (e) parent was divested of management authority, each had separate departments for administrative functions, and parent did not influence subsidiary's operations in ways grounded in its own operational expertise and overall strategy).

Clarcor, Inc. v. Hamer, 2012 IL App (1st) 111674 (1st Dist. App. Ct. 2012) (centralized cash management significant feature of horizontal integration).

Shaklee Corp v. Department of Revenue, No. 1-96-3780, unpublished order (1st Dist. App. Ct. 1998) (inserting additional layer of non-operating holding companies in corporate structure does not break unitary chain).

A.E. Staley Mfg Co. v. Zehnder, No. 1-99-1822, unpublished order (1st Dist. App. Ct. 2001) (evidence suggested subsidiary operated independently and was responsible for its own business operations).

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Tomen America, Inc. v. Zehnder, No. 1-98-3841, unpublished order (1st Dist. App. Ct. 2001) (use of stock sale proceeds to pay down lines of credit and make short-term investments, including purchasing CDs and commercial paper, was sufficiently operational for Illinois income tax to attach to dividends and capital gains realized from the sale of non-unitary stock).

BP Oil Pipeline Co. v. IDOR, Nos. 1-01-2364 & 1-01-2365, consolidated with Unocal Pipeline Co. v. IDOR, unpublished order (1st Dist. App. Ct. 2004) (unitary partnership income must be apportioned based on combination of all unitary members' respective factors).

Cincinnati Casualty Company v. Glen Bower, No. 00 L 50254 (Cir. Ct. Cook County 2001) (in order to be a holding company included in the unitary business group of insurance companies, must be formed solely to hold stock in one or more other corporations and not engage directly in own business operations).

Consol, Inc., vs. Glen Bower, Illinois Circuit Court, Cook County, No. 01 L 51196 (Cir. Ct. Cook County 2003) (parent not involved in day-to-day operations but loaned subsidiaries vast sums and earned interest).

Abernathy Specialties, Inc. v. Department of Revenue, Administrative Decision IT 02-9 (2002) (three separate divisions of company were not sufficiently integrated to constitute a single trade or business).

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D. EDA 132 : UNITARY QUESTIONNAIRE

Illinois Department of Revenue

EDA-132 Information and Document Request For Affiliated Companies

General Information

The purpose of this document request is to obtain information related to affiliated companies. If you prefer to receive this document in an electronic format, it can be provided as an attachment to an email, as long as you waive any issues of confidentiality or privacy pertaining to the information requested. This informational request is authorized under 35 ILCS 5/914 and 5/916, and 20 ILCS 2505/2505-315. The information is requested in addition to any other document request we may issue. It is not intended to be inclusive, and we may request additional information as the result of any response we receive. If you have any questions, please contact me at the phone number or address listed below.

Identify the taxpayer and audit period (auditors)

Name:

Address:

Audit Period:

FEIN:

Submitted to:

Date submitted:

Auditor's Name:

Auditor's mailing address:

Auditor's phone no.:

Step 1: Provide the following contact information (taxpayers)

1. Write the name and phone of the person we should contact if we have any questions about the information you submit to us.

   Name of contact person _____ phone number _____

2. Write the names and titles of all persons who responded to or assisted in any way in responding to this questionnaire and the information that you are submitting to us. If you need additional space, you may attach a separate sheet of paper.

Name	Title	Name	Title

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Step 2: Provide the following documents and information for the entire audit period (taxpayers)

1. U.S. Form 851
2. U.S. Form 1120, Schedule K, including corporate ownership, affiliation attachments, and supporting answers to line items 3 and 5.
3. List any corporation that is owned directly or indirectly, by more than 50 percent by this company and is not already listed on U.S. Form 851, and U.S. Form 1120, Schedule K.
4. List all partnerships in which you or any corporation on U.S. Form 851, Schedule K, or the list referred to in line item 3 has a general partnership interest.
5. List any member-managed LLC's in which you or any corporation on U.S. Form 851, Schedule K, or the list referred to in items 3 or 4 has an interest.
6. Provide an organizational chart showing the relationship of each of the entities referenced in line items 1 through 5.
7. Identify all entities listed in items 1 through 5 with an Illinois activity, even if you believe that it is protected from Illinois income taxation by P.L. 86-272, by another federal law, or by treaty.
8. For any entity listed in items 1 through 5 that you assert to be an 80/20 company, provide all supporting calculations.
9. If you file annual reports with the SEC, please provide copies of Forms 10-K or 20-K for each year in the audit period.
10. If you do not prepare annual reports or SEC Forms 10-K or 20-K, provide a detailed description of your business operations/segments, locations, and products.
11. Supply documentation to support any of the entities listed in items 1 through 5 being treated as financial organizations, transportation or insurance companies.
12. Explain the basis for the filing method you used on your Illinois tax return, specifically indicating the reason for filing the way you did. If any business entity is included in any of the lists in line items 1 through 5 but is not included in your unitary business group, as indicated on Schedule UB, explain why.
13. If you filed on a unitary basis, did you make any changes to the unitary group since the return you filed for the last year prior to the audit period? Identify new members, as well as members no longer included in the group. If anyone is included in line items 1 through 5, but is not included in your unitary business group as filed, explain why,
14. Do you file a unitary tax return in other states? If yes, list those states.
15. Is the unitary group, as reported to Illinois, the same unitary group as reported to other unitary states? If not, identify the entities listed in items 1 through 5 that are treated differently for Illinois purposes than for purposes of any of the other states in which you file a unitary return, and why those members were not included in (or excluded from) the unitary group as reported to Illinois and treated otherwise for another state.
16. Provide the verification/source data for your apportionment work papers. Include
    a) Forms U.S. 941 and IL-941;
    b) Illinois Department of Employment Security Form "UI-3/40"
    c) Other source documents that might reveal the cost of labor, which is included in the costs of goods sold;
    d) "Source" documents for any apportionment data given to the auditor.
    e) Property, rent, and inventory apportionment data
    f) Identify all origin and destination sales for each entity listed in item numbers 1-5 above.

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17. Provide detail of all eliminations made on the consolidated U.S. Form 1120 and the Illinois Schedule UB.

18. Identify all of the manuals used in your business, including operational, and policy or procedural, and make those manuals available to auditor upon arrival at your facility. If reporting requirements are not included in any of these manuals, but are memorialized on any other form, provide those documents.

    a) Examples of these manuals include, but are not limited to:
        1) Advertising
        2) Marketing
        3) Accounting
            - Budget requirements, procedures, and limitations
            - Capital authorization levels
            - Large expenditure approval requirements
        4) Personnel
        5) Records retention
        6) Treasury functions
        7) Forms manuals
        8) Internal audit manuals (e.g., employee handbooks)

19. Identify all centralized functions/departments within the entities listed in items 1 through 5 and the reporting requirements of these centralized functions/departments, including parent to affiliate or subsidiary, or subsidiary or affiliate to parent.

    a) Identify the services provided by each function/department to any entity listed in items 1 through 5, and indicate if there is any payment for such services among those members. Examples of centralized functions/departments include, but are not limited to
        1) Purchasing
        2) Financing
            - Inter-company lending (identify source of funds; identify lender and borrower by name, amounts lent or borrowed and interest income and expense accrued or paid in each taxable year in the audit period).
            - What was the total amount of inter-company loans that were repaid by the company indicating the payor and payee and the dollar amount?
            - Requirements and procedures regarding borrowing from unrelated third parties for the parent corporation, divisions, and subsidiaries or affiliates.
                - Identify the amount below which no approval or authorization is required by the parent corporation.
                - Identify each financing of this type during the audit period by date, borrower, lender and amount.
                - Who provided the approval or authorization for each financing?
                - Who sets the borrowing limits?
                - What is the process for seeking the approval or authorization?
                - What is the frequency of request for approval or authorization? Provide this information by date, company making the request, and the amount requested.
            - Lists of all banks with which any entity listed in items 1 through 5 does business or has accounts.
            - Access to all inter-company loan agreements between entities listed in items 1 through 5 as well as payment or pay-off schedules, including bank statements evidencing such payments.
        3) Tax Compliance
        4) Product Line
        5) Personnel/Hiring/Transfers
        6) Marketing
        7) Capital Investment
        8) Research and Development
        9) Accounting and Budgets
        10) Data Processing and MIS/Computers
        11) Internal Audit
        12) Insurance (provide copies of policies)

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13) Employee Benefits (if separate from personnel information)
14) Legal Services
15) Physical Facilities Use
16) Advertising
17) Warehousing
18) Transportation
19) Technical Services or Licensing Agreements
20) Labor Relations
21) Training

20. Identify the manager of each centralized function or department by name, title, location, telephone number, job description, the entity the manager works for, and the person to whom the manager reports, identifying that person by title and the entity for whom that individual works.

21. If centralized functions or departments do not exist, identify all of the redundant functions and departments in the entities listed in items 1 through 5.
    a) Identify each separate department of the parent organization, and
    b) Identify each separate department of each entity listed in items 1 through 5 by title, location and manager of the department.

22. Identify all inter-company transactions (other than loans identified under "Financing" in item 19(a)(2)), between any of the entities listed in items 1 through 5. Identify these transactions by the names of the entities and the related dollar amounts.
    a) Identify each inter-company account in the detail of the general ledge by account number
    b) Identify inter-company sales of components or finished goods to purchasing subsidiaries and whether that subsidiary purchased the components form any other source. Identify the subsidiary by name and by amounts purchased internally and externally.
    c) Identify the total amount of inter-company sales (purchases) made by each entity for each year, and identify the percentage that those amounts bear to the total sales (purchases) of that entity.

23. Identify and provide a list of all officers, directors, managers and partners of all entities listed in items one through five.

24. Provide Board of Directors minutes, committee minutes, and shareholder minutes of the parent corporation for the audit period. (It may be necessary to review other committee minutes and affiliated members after we've reviewed the parent's minutes.) Examples of committees of the Board of Directors include, but are not limited to:
    a) Audit committee
    b) Personnel committee
    c) Executive Compensation committee
    d) Environmental committee

    This request includes any and all minutes that refer to any of the information requested in this questionnaire.

25. Provide any reports, statements, or certifications required by local, state, or federal regulatory agencies for each entity listed in items 1 through 5 that is engaged in a "regulated" industry.

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E. GUIDANCE – PARTNERSHIP/PARTNER SALES ELIMINATION

Under 86 IAC § 100.3380(d) sales made by the partnership to a unitary partner or vice versa are not eliminated from the partner's sales factor for tax years beginning prior to June 30, 2008. For tax years beginning on or after June 30, 2008, intercompany sales are eliminated from the unitary partner's sales factor. 86 IAC § 100.3380(a) provides that, for tax years beginning prior to June 30, 2008 if the unitary partner did eliminate sales on its returns as filed, then that elimination will be allowed. If eliminations were not made, then the taxpayer may petition the Department under IITA § 304(f) to apply the regulation retroactively.

Auditors should instruct any taxpayer seeking to eliminate transactions for years beginning before June 30, 2008 to provide the auditor with an amended return along with a petition for alternative apportionment that complies with the requirements contained in IAC § 100.3390. Once the auditor receives the petition and amended return(s), the following procedures will be followed:

1. After confirming that the amended return is signed and contains the proper attachments, the auditor should accept it by writing "Received by the IL Dept. of Revenue" on the return and initialing & dating it. (The same can be done for the for the taxpayer's copy.)

2. The audit supervisor must review the petition to ensure that it meets the requirements of 86 IAC § 100.3390(e)(2).

3. The petition along with the amended return(s) will be forwarded to Technical Support at:

Illinois Department of Revenue
Income Tax Technical Support, 3-329
101 West Jefferson Street
Springfield, Illinois 62704

4. Incorrect petitions will be returned to the taxpayer (through the auditor) along with written instructions on how to make the petition compliant with our regulation.

5. Technical Support will issue a memo approved by Legal Services authorizing the elimination.

6. The auditor will allow the elimination in their audit.

7. Auditors must include a memo in their audit file and thoroughly discuss the circumstances in their Audit Comments.

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Auditor Initiated Requests
At this time the Department is NOT imposing IITA § 304(f) adjustments on taxpayers during the normal course of an audit, except as noted above.

F. WATERS EDGE / WORLD WIDE APPORTIONING STATES

Worldwide combination is the term used to describe a unitary business group composed of entities whose business activities are performed anywhere in the world. The terms domestic and water's-edge are used synonymously below to describe a unitary business group whose members are limited to entities with greater than 20% of their business activities being performed within the fifty United States and the District of Columbia. The two terms are used since some state statutes refer to domestic combination and others to water's-edge combination. The following states currently have provisions in their statutes for using the unitary apportionment method to compute the amount of income which is properly taxable in their state:

ALASKA	**domestic/water's edge combination for non-oil companies**
ARIZONA	domestic/water's-edge combination
CALIFORNIA	worldwide combination or water's-edge at the taxpayer's option
COLORADO	domestic/water's-edge combination
HAWAII	domestic/water's-edge combination
IDAHO	worldwide combination or water's-edge at taxpayer's option
ILLINOIS	domestic/water's-edge combination
INDIANA	water's-edge is mandatory
KANSAS	domestic/water's-edge combination
KENTUCKY	domestic/water's-edge combination
MAINE	domestic/water's-edge combination
MICHIGAN	domestic/waters-edge mandatory
MINNESOTA	domestic/water's-edge combination
MISSISSIPPI	domestic/water's-edge combination
MONTANA	worldwide combination or water's-edge at taxpayer's option
NEBRASKA	domestic/water's-edge combination
NEW HAMPSHIRE	domestic/water's-edge combination
NEW MEXICO	water's-edge combination at taxpayer's option
NEW YORK	domestic/water's-edge combination
NORTH DAKOTA	worldwide combination or water's-edge at taxpayer's option
OHIO	
OREGON	domestic/water's-edge combination
UTAH	domestic/water's-edge combination
VIRGINIA	domestic/water's-edge combination
WEST VIRGINIA	domestic/water's-edge combination

REF: 2010 Multistate Corporate Tax Guide, Volume 1, and RIA Checkpoint 2014.

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G. PROPERTY FACTOR ISSUES PERTAIINING TO OIL COMPANIES

For the tax years ending prior to December 31, 1998, Illinois had relied upon a three-factor apportionment formula of property, payroll and sales. In 1998 the Department began phasing out the property and payroll factors over a three year period, leaving a single sales factor in the third year. For tax years ending on or after December 31, 2000, only sales are used in Illinois to figure the apportionment factor.

However, in the event of a 304(f) application or the need to audit an oil or gas concern for tax years ending prior to December 31, 1999 this information may be required. A complete recitation of the property factor discussion (except oil) may be found in Chapter 27 in the Historical Extracts and Exhibit section. The following pertains to the oil and gas property factor.

1. Property Factor-Depletable Property and Depletion

A frequent issue in audits of oil companies is whether or not depletable property should, for the property factor, be valued at "original cost" (before deduction of accumulated depletion). It is the Department's position that including depletable property at original cost is consistent with the rules relating to the property factor, and to do otherwise will be in violation of the Act. There is also, at this time, no method for making any adjustment to inventory or the sales factor due to the depletable property.

a) Property Factor-Intangible Drilling and Development Costs

The IRS regulations define intangible drilling costs (IDCs) as any cost incurred that, in itself, has no salvage value and is "Incident to and necessary for drilling of wells and the preparation of wells for the production of oil and gas." The federal regulations furnish examples of these costs, which include such items as wages, fuel, repairs, hauling, supplies, etc., incurred in drilling, clearing and draining of the ground, road making and so on.

At the taxpayer's option, the IDC may be charged to capital or expensed. This election is available to the taxpayer under IRC § 1.612-4(a). Most oil and gas companies will make the election to expense the IDC.

Illinois had always taken the position that only capitalized IDCs could be included in the property factor since, if the taxpayer expensed the IDCs,

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the taxpayer had never "acquired" an asset for federal purposes. However, in September of 1992, the Circuit Court of Cook County handed down a decision in the case of Shell Oil Company et al v. Illinois Department of Revenue which caused the Department to reverse this position. Therefore, for all tax years for which the statute of limitations for issuing a notice of deficiency or filing a claim has not expired, IDC's should be included in the property factor whether or not they have been capitalized or expensed for federal purposes.

Since Illinois had no published position (statutes, regulations, etc.) regarding the treatment of IDCs in the property factor, the court relied on positions taken by other states, other states' courts and the MTC. The court put a tremendous amount of weight on an Oregon Supreme Court decision, Atlantic Richfield Company v. Oregon Department of Revenue (1986). In the Atlantic Richfield case, Oregon noted that one of the main goals of UDITPA was "uniformity of application of the statutes' among jurisdictions" and that the majority of jurisdictions that had considered the IDC question required that they be included in the property factor whether the IDCs were expensed or capitalized.

The Illinois court also placed significant importance on the 1988 amendment to the MTC regulations which requires that IDCs be included in the property factor whether they are expensed or capitalized. The Illinois court stated,

> Illinois embodied the MTC's principles in the IITA and has given no further guidance with regard to IDCs such as a rule, regulation or statutory language. Therefore, including IDCs in the property factor of the apportionment formula is consistent with the only stated expressions of legislative intent behind the IITA with regard to the apportionment formula, property factor and IDCs.

Refer to Chapter 49 for a synopsis of the Shell Oil Company v. Illinois case, and the Atlantic Richfield Company v. Oregon case and for complete citations for both cases.

86 IAC § 100.3350(e)(2) was promulgated by the Department . This change to the IAC allowed for the inclusion of capitalized IDC whether or not they were expensed or not for federal or state tax purposes. IDC was defined to include wages, fuel, repairs, hauling, draining, road-building,

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surveying, geological works, construction of derricks, tanks, pipelines, and other physical structures necessary for the drilling of wells and their preparation for the production of oil and gas, and supplies incident to and necessary for the drilling of wells and clearing of ground

A good portion of any IDC claimed is usually related to joint venture operations, however, most of it will generally be accounted for in the income statement or balance sheet of the production and exploration company (the partner). If it is determined that the joint venture is not unitary with the partner and the partnership income is going to be allocated per Section 305(a) of the IITA, it is important to verify that all IDC relating to the joint venture operations is excluded from the partner's taxable income and/or balance sheet accounts.

b) Oil Company Property Factor-Rent/Royalty Expense

A second area of the property factor computation which, must be given special attention when dealing with the oil and gas industry is rent expense. The rent expense figure reported on the federal return may include other types of expenses which are not properly includable in the property factor.

A typical oil and gas lease may stipulate that the lessee pay to the lessor three general types of consideration:

(i) LEASE BONUS AMOUNTS

These are generally negotiated in conjunction with the royalty amount. LEASE BONUS amounts are sometimes referred to as advance royalties since the BONUS is a cash payment made by the lessee to the landowner in consideration for granting a lease on the property whereby the lessee acquires the right to enter upon the leased premises and explore for oil and gas, customarily for a year from the date of the lease.

Generally speaking, the higher the BONUS, the lower the royalty and the lower the BONUS, the higher the royalty. A lower BONUS amount is usually negotiated for land where the production potential is very speculative. Once the productivity is proven, the higher royalty corresponds to the actual value of the property.

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2. Delay Rentals

These are periodic payments made to keep a lease in effect during the period prior to production. The payments are made to the landowner for additional time in which to commence exploration and drilling of the property. For example, a lease may be in effect for a period of five to ten years however the lessee may be required to commence drilling within one year. If drilling has not started by that time the lease could be terminated unless the lessee pays the lessor DELAY RENTALS.

Delay rentals are considered rents since they accrue by mere lapse of time.

3. Royalties

Royalties are periodic payments made based on production. A royalty is NOT burdened with the costs, i.e. bears no portion of costs of development or operation of the property. A royalty interest is the interest in oil and gas or minerals in place that is retained by the landowner (the lessor) which entitles him to a specified portion of the production. Most royalties are paid either in cash or in-kind. The rights to production, granted under oil leases, are generally determined by industry custom and most commonly are; 7/8th in cash (or in-kind) to the lessee and 1/8th in cash (or in-kind) to the lessor.

Royalties are paid to the owner of the land because the owner retains an ECONOMIC INTEREST in the property being leased. The royalty payment represents a defined fraction of production reserved for the owner or sold for his account. Conversely, rent is paid because an oil and gas lease grants a lessee the right to a fixed portion of production in return for the risks undertaken in exploring and developing the property; and reserves for the lessor a fixed portion of the production for the retained royalty interest. The lease agreement may also include some, or all, of the following types of payments:

a) Overriding Royalties

This type of payment is similar to a royalty except that it is created from the working interest of the lessee. The lessee assigns his working interest to a third party and retains 1/8th of his 7/8th interest in the minerals in place. The lessee's share (1/8th x 7/8th) is said to be the overriding royalty. An overriding royalty is also free of development and operation costs.

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b) Shut-In-Royalties

If a producing well is shut for some reason, the leases provide for shut-in payments. These payments are regarded as rent as opposed to royalty. This is because shut-in-royalties are paid, not in contemplation of production, but are payments made solely because there will be no production.

Including the rent expense of non-producing leases is not in violation of the "used in the trade or business" requirement of Section 304(a)(1)(A) of the IITA, since the exploration for oil is a crucial element of the industry. In the case of the State Department of Revenue v. Amoco Production Co., 676 P.2d 595 (Alaska 1984), the Alaska Supreme Court held that the non-producing leases did constitute property "used" in the State within the meaning of the UDIPTA property factor regulations.

The Court held that:

> The non-producing oil and gas leases are an example of non-obvious contributions to Amoco's production of income. The exploration and development of what later turn out to be unproductive oil or gas wells is a necessary and integral part of Amoco's eventual discovery and exploration of productive oil and gas wells. To say that only property values associated with oil and gas leases which are known to contain recoverable quantities of oil and gas should be included within the property factor is to ignore the actual business activities that lead up to Amoco's ability to derive oil and gas income.

A synopsis of the Amoco Production Company case can be found in Chapter 49.

Delay rentals and shut-in-royalties received by the lessor are not subject to depletion allowance. Whereas production (and other) royalties and income received by the lessor because of his right to share in the production of the minerals-in-place are subject to depletion allowance.

The following paragraph, taken from Arthur Young's Oil & Gas, 1986 Edition, (page 163, 11.7), further explains the difference between the various types of royalties:

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Royalty payments, though sometimes referred to as rents, are distinguished on the grounds that they represent a division of the mineral produced. Rents, such as DELAY RENTALS in an oil and gas lease, accrue by mere lapse of time. A delay rental differs from a BONUS in that such rental is not paid for oil to be produced but for additional time within which to begin utilization of the land. So-called SHUT-IN ROYALTIES have been characterized as rent for federal income tax purposes because of their similarity in providing the lessee with additional time to begin production, rather than according him a basic right to produce the mineral. (Emphasis added)

In summary, when determining the correct amount of rent expense, we should allow the inclusion of payments made in respect of delay rentals and shut-in-royalties. Payments of production royalties, bonus/advance royalties and overriding royalties should not be included in rent expense.

The Department held the opinion that for the rent expense, we should allow the inclusion of payments made in respect of delay rentals and shut-in-royalties, but payments for production royalties, bonus/advance royalties and overriding royalties should not be included in the rent expense. However, the issue was revisited during a Protest Act case.

The Department reversed its position in November of 2000 and determined that ALL royalty payments for a leasehold interest in land should be included in rent expense for property factor purposes.

When verifying the apportionment formula factors, it is important to determine if any of the lessor's share of production-in-kind has been sold by the lessee, and is included in the gross sales of the lessee. The reimbursements to the lessor for the same, would then be expensed as royalty payments. In these instances, these sales are not actually sales of oil owned by the lessee, but rather, are sales on account for the lessor. As such, the receipts from these sales should not be included in the sales factor of the lessee.

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ILLINOIS INCOME OR LOSS (FTI & ADD MODS)

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I. PURPOSE

To assist auditors in making a determination of properly reportable income for Illinois income tax purposes in order to arrive at Illinois taxable income or base income. Base Income is defined in IITA § 203 as equal to the taxpayer's taxable income modified by certain items specified within the Act. For corporations, the numerous addition modifications begin at IITA § 203(b)(2)(A). These modifications are elaborated upon within this chapter of the Income Tax Audit Manual. Partnerships, Trusts and Estates are discussed in Audit Manual chapter 28 and Individual income taxpayers are covered in chapter 45. Subtraction modifications are discussed in Chapter 25.

II. REFERENCE RESOURCES

A. Illinois Income Tax Act

IITA § 203(b)(2)(A-E16)
IITA § 203(e)
IITA § 506(b)

B. Illinois Regulations

IAC § 100.2193
IAC § 100.2300(c)
IAC § 100.2405(c)
IAC § 100.2430
IAC § 100.2435
IAC § 100.2455
IAC § 100.2470
IAC § 100.3380
IAC § 100.5030
IAC § 100.5265
IAC § 100.5270
IAC § 100.9200
IAC § 100.9700
IAC § 100.9750

C. Department Publication

Publication 101

D. Federal Regulation

26 CFR § 1.1502
26 CFR § 1.168

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26 CFR § 1.482-1
26 CFR § 301.7701

III. GENERAL INFORMATION

The type of return filed with Illinois is dependent upon the return filed with the IRS.

A. Partnerships, S-Corps, Trusts and Estates

Chapter 28 of the Audit Manual covers partnerships, Subchapter S corporations, trusts & estates. Refer to that chapter regarding the rules for determining income for IL-1065 (Partnership), IL-1120ST (S-Corp) or IL-1041 (Trusts and Estates) filers.

B. Illinois Taxable Income

Unitary determination is made based on Audit Manual Chapter 23. The next step is to compute the proper amount of federal taxable income. This computation will vary depending on whether the company is filing:

1. a “separate” Illinois return, or
2. as part of a unitary business group.

C. Federal Schedule M-3

Any domestic corporation or group of corporations required to file Form 1120, U.S. Corporation Income Tax Return, that reports on Form 1120, Schedule L, Balance Sheets per Books, total assets at the end of the corporation's tax year that equal or exceed $10 million must complete and file Schedule M-3 instead of Schedule M-1, Reconciliation of Income (Loss) per Books With Income per Return. A corporation or group of corporations that is required to file Schedule M-3 must also file Schedule B, Additional Information for Schedule M-3 Filers.

Schedule M-3, Part I, asks certain questions about the corporation's financial statements and reconciles financial statement net income (loss) for the corporation (or consolidated financial statement group, if applicable), as reported on Part I, line 4a, to net income (loss) of the corporation for U.S. taxable income purposes, as reported on Part I, line 11.

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Schedule M-3 parts II and III reconcile financial statement net income (loss) for the U.S. corporation (or consolidated tax group, if applicable), as reported on Schedule M-3, part I, line 11, to taxable income on Form 1120, page 1, line 28.

There is a unique separate Schedule M-3 for taxpayers required to file Form 1065, U.S. Return of Partnership Income; Form 1120S, U.S. Income Tax Return for an S Corporation; Form 1120-F, U.S. Income Tax Return of a Foreign Corporation; and for Forms 1120-PC or 1120-L. No Schedule M-3 is required for taxpayers filing Form 1120-REIT, U.S. Income Tax Return for Real Estate Investment Trusts; Form 1120-RIC, U.S. Income Tax Return for Regulated Investment Companies; Form 1120-H, U.S. Income Tax Return for Homeowners Associations; and Form 1120-SF, U.S. Income Tax Return for Settlement Funds.

D. Modifications

IITA § 203(b) provides for numerous modifications to corporate taxable income to arrive at base income. Furthermore, IITA § 203(h) and IAC § 100.2405(g) explains that no modification shall be made unless authorized by the Act. Therefore, the only additions or subtractions to taxable income which are allowed in the computation of base income are those that are expressly authorized by the Act.

When dealing with a unitary group of companies it is important to remember that the modifications apply to all members of the unitary group, not just the Illinois filers. Due to the nature of some of the modifications, an Illinois filer may be the only one affected by a specific modification (such as the Illinois Income Tax deducted addition or the Illinois Income Tax refund subtraction), however, in general all unitary group members should be examined to determine applicability of Illinois modifications.

Public Act 88-660, effective September 16, 1994, created IITA § 250. This section provides that all exemptions, credits and deductions enacted after September 16, 1994 shall be limited by a reasonable and appropriate sunset date. If a sunset date is not specified in the Public Act which creates the exemption, credit or deduction, the exemption, credit or deduction will automatically expire for tax years beginning on or after five years after the effective date of the Public Act creating the exemption, credit or deduction unless exempt from Section 250 or extended by other applicable law. For example, Public Act 97-0636 added subsection (b) to provide that any exemption, credit, or deduction scheduled to sunset in years 2011, 2012, or 2013 are extended an additional five years. These would be extended to then expire in 2016, 2017, or 2018.

IV. APE SPECIFIC LAW APPLICATIONS

A. Separate Corporate Taxable Income

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A corporation's Illinois pro forma income should agree with its federal taxable income if the company files a separate company return both federally and for Illinois. If the corporation is a member of a federal consolidated group, however, the determination of a corporation's Illinois pro forma income amount, which they are required to compute regardless of the type of Illinois return filed, can be a complex task.

1. Illinois Pro Forma Income

a) Auditors should examine:

(1) All federal returns filed by the affiliated (not consolidated) group
(2) Supporting schedules
(3) Backup workpapers

IITA §§ 913 and 506(a) provide the authority to examine the federal returns, including supporting schedules, filed by the taxpayer in order to determine the proper Illinois pro forma income amount.

Federally, corporations can file either a separate or consolidated return depending on the makeup of their group. Regardless, they must calculate separate taxable income in accordance with 26 CFR § 1.1502-12. In some circumstances, affiliated corporations may not all file as part of the same federal return.

Example: Corp A, a domestic company, owns 100% of Corp F, a foreign subsidiary. Corp F owns 100% of domestic Corp D. Corp A is therefore the indirect parent of Corp D; however, since Foreign Corp F is the direct owner of Corp D, Corp D may not file as part of Corp A's federal return.

Federal "separate taxable income" of all members of the consolidated return is recorded on a spreadsheet of the consolidated return. Federal consolidating adjustments which are required by 26 CFR § 1.1502-12 may either be identified as such on the spreadsheet or may have already been incorporated into these "separate taxable income" figures. Many of these adjustments would not have been made had the companies not filed a federal consolidated return in the current year or in preceding years.

The "separate taxable income" reported by a company on the federal consolidated return spreadsheet should not be routinely accepted as Illinois pro forma income. The federal "separate taxable income" should be examined and adjusted to reflect the income which the company would have reported on its federal return, if it had filed separate company returns for the current year and all preceding taxable years.

Example: Company A owns 100% of the stock of Companies B, C, and D. The four companies have filed a federal consolidated return for the years 2008, 2009, 2010

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and 2011. In 2008, 2009 and 2010 Company B incurred federal net operating losses, which reduced the amount of consolidated income the group reported on its US 1120's. Due to 26 CFR § 1.1502-11, Company A is required to reduce its basis in Company B's stock in each year in which Company B incurred a loss. In 2011, Company A declares the stock of Company B worthless. The capital loss reflected on Company A's federal "separate taxable income" statement is based on the reduced basis of Company B's stock.

For Illinois purposes, the companies file separate Illinois returns in all years. Since each company's Illinois pro forma income is computed as if the companies had filed separate federal returns for the current year and each of the preceding years, Company A would not have been required, on a federal separate company basis, to make the adjustment to the basis of Company B's stock in the preceding years. Therefore, in the year in which the stock was declared worthless (2011), Company A would compute its capital loss for Illinois pro forma purposes on the original basis of Company B's stock.

Example: Corp M filed a combined IL-1120 for 2015 that included Corp Z. Corp Z reported a federal capital gain of $10 million from the 30% sale of partnership interests to Corp F, the financial arm of Corp M. Corp F filed a separate US 1120 because it is owned by a subsidiary of Corp M in Europe. The taxpayer excluded Corp F from the unitary group as an 80/20 company. The $10 million gain is properly included in federal taxable income on the IL-1120 of Corp M. If the auditor determines that Corp F is not an 80/20 and should be a member of the Corp M's unitary group, then the capital gain will be eliminated from federal taxable income as an intercompany adjustment under IAC § 100.5270(a)(1).

Example: The parent corporation, Corp P, is a holding company that owns 100% of Sub 1. Sub 1 owns 50% of Sub 2 and Corp P owns the remaining 50% of Sub 2. Sub 1 is selling its entire 50% interest to Corp P. Corp P will then directly own 100% of Sub 2. Corp P, Sub 1, and Sub 2 file as members of a consolidated US 1120. Under consolidating federal rules, the gain is deferred and eliminated as intercompany.

On a separate company basis, the gain is not deferred. However, if Corp P and Sub 1 are proper members of a unitary business group, IAC § 100.5270(a)(1) requires members of the unitary group to follow the federal consolidated return regulations, so the gain is eliminated on the Illinois Schedule UB.

For tax years ending on or after December 31, 1986 taxable income for Illinois purposes can be less than zero in loss years. Loss carryforwards from taxable years ending prior to December 31, 1986 may not exceed the sum of federal taxable income for the taxable year before the net operating loss deduction plus the excess of addition modifications over subtraction modifications for the taxable year. For information regarding tax years ending before December 31, 1986 see the "Historical Extracts" section later in this chapter. For

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more information regarding net operating losses and net operating loss deductions refer to Chapter 35.

If the company is filing a separate company return for Illinois, the federal pro forma taxable income is entered on Line 1 of the IL-1120. When computing this figure take special care to consider charitable contributions and capital gains computations on the federal return.

The total amount reported on the US 1120 charitable contributions line (19 on the 2012 form) cannot exceed ten percent of taxable income (Line 30) calculated without regard to specified deductions. Refer to IRC § 170 and federal Form 1120 instructions for more information.

Capital losses (Line 8 on the 2012 federal Form 1120) are only allowed to the extent of capital gains. Taxpayers are required to attach federal Schedule D to show the calculations of this line.

Auditors need to review these items to confirm the amounts reported prior to arriving at the federal taxable income reported on Line 1 of the IL-1120.

2. Special Rules for Certain Filers

IAC § 100.2405(c) provides several special rules for specific types of entities. The following entities have special rules relating to taxable income, IAC § 100.2405(c)(1)-(6):

a) Certain life insurance companies – IITA § 203(e)(2)(A);
b) Mutual insurance companies – IITA § 203(e)(2)(B);
c) Regulated investment companies (RICs) – IITA § 203(e)(2)(C);
d) Real estate investment trusts (REITs) – IITA § 203(e)(2)(D);
e) Consolidated corporations – IITA § 203(e)(2)(E)
f) Cooperatives – IITA § 203(e)(2)(F)

Insurance companies are discussed in Chapter 31. In addition, IAC § 100.2405(c)(7) and (8) refers to the computation of Subchapter S corporation and partnership federal taxable income. Chapter 28 contains information regarding these types of entities.

B. Unitary Corporate Income

Under IAC § 100.5270(a)(1) for corporations who are members of a unitary group filing an Illinois combined return, unitary taxable income is computed by treating all members of the unitary business group (other than ineligible members) as if they constituted a federal consolidated group. 26 CFR § 1.1502-11 on Consolidated Taxable Income will be used to determine unitary taxable income for those members included in the unitary group. See section below on “Other Federal Rules Regarding Consolidated Adjustments.”

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The unitary taxable income is computed on the Schedule UB, Part II, by adding the Illinois pro forma incomes of all the members of the unitary group. In addition, certain "consolidating" adjustments and offsets are allowed.

1. Consolidating Adjustments

a) Federal Net Operating Losses:

A federal net operating loss incurred by one member of the group is allowed to offset income of other members of the group, and can result in the unitary group incurring a net operating loss for the taxable period. For more information, refer to Chapter 35.

b) Intercompany Transactions:

Intercompany transactions between members of the same unitary business group may result in income and/or expenses which, if not eliminated, will distort the unitary business group's combined income. Examples of such income items are not limited to:

(1) fees received from other members of the group for management and other services, rents, royalties, interest and dividends.
(2) transactions resulting in charges to expense, asset, surplus or other accounts, which must be eliminated if they cause a distortion of income.
(3) unrealized profit contained in a unitary business group member's ending inventory as a result of intercompany sales of merchandise unless the unrealized profit in ending inventory tends to remain constant from year to year, thus not causing a substantial distortion to income. REF: IAC § 100.5270(b)(1)

c) Capital Losses:

A capital loss incurred by one member of the group is allowed to offset the capital gains incurred by other members of the group. No capital loss is allowed in excess of the unitary group's capital gains. Any excess capital loss must be used in carryback or carryforward years in accordance with 26 CFR § 1.1502-22 on consolidated capital gain or loss. For more information, refer to Chapter 35

d) Capital Loss Carryovers:

Capital loss carryovers are allowed to offset unitary capital gains in the same manner and subject to the same limitations as net operating loss carryovers for

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losses incurred in years ending prior to December 31, 1986. A capital loss may be used to offset capital gains only. It may not be used to offset ordinary income.

Refer to Chapter 35 for further information regarding the limitations on net operating loss and capital loss carryovers.

e) Charitable Contributions:

The charitable contributions made by the members of the unitary group are allowed as a unitary group and in accordance with 26 CFR § 1.1502-24. In the case of a corporation, IRC § 170(b)(2)(A) provides in general that the total deductions for any taxable year shall not exceed ten percent of the taxpayer's taxable income.

2. Part Year and Different Year End Members

The income of part-year members of the group is included in the unitary taxable income figure for the portion of the year for which the corporation is a member. The amount of income to be included can be computed using one of the three methods described in IAC §§ 100.5265 and 100.5270(f).

For tax years ending on or after December 31, 1987, members of a combined group may have different taxable year-ends. Per IAC § 100.5265(b), members of the unitary group with different tax year-ends must adjust their income, modification and apportionment figures to reflect the same time period as the remainder of the unitary group. Three options for making the adjustment are presented in IAC § 100.5265.

Taxpayers are allowed to choose which method they want to follow, but generally they must apply that method to all subsequent returns unless one of the exceptions in IAC § 100.5265(c) applies.

3. Other Federal Rules Regarding Consolidating Adjustments

It is the auditor’s job to determine if adjustments are allowable – not whether they were shown as an adjustment on the federal return, or removed before the computation of the federal return figures. The information in the following paragraphs will be helpful when the unitary business group has different members than the consolidated return group (or where multiple federal returns are filed by the members of a unitary business group).

26 CFR §1.1502-11 (Consolidated Taxable Income) states that consolidated taxable income is computed beginning with "separate taxable income". The "separate taxable income" of each member of the group is computed in accordance with the provisions of

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the Code covering the determination of taxable income of separate corporations, subject to modifications. Refer to 26 CFR §1.1502-12 through 1.1502-42 and those referenced within.

"Separate taxable income" is then modified to arrive at consolidated taxable income by the following adjustments:

a) The addition of any consolidated capital gain net income which is computed in accordance with 26 CFR § 1.1502-22.

b) The subtraction of any consolidated charitable contributions (defined in IRC § 170) deduction (computed in accordance with 26 CFR § 1.1502-24).

(1) can be carried forward five (5) taxable years.
(2) shall consist of
(a) any excess contributions of the group, plus
(b) any excess contributions of members of the group arising in separate return years of such members.
(3) is allowed if the contributions made during the carryforward year are less than the 10% limitation.
(4) contributions for the carryforward year plus the carryover cannot exceed the 10% limitation.

Note: The federal consolidated return regulations also provide that the deduction should not include any excess contributions apportioned to a corporation for a separate return year pursuant to 26 CFR § 1.1502-79(e). However, IAC § 100.5270(a)(1) expressly provides that the separate return limitation rules do not apply to the computation of pro-forma federal taxable income, and so this limitation should be ignored.

c) Any consolidated Section 922 deduction for Western Hemisphere Corporations (computed in accordance with 26 CFR § 1.1502-25, however, *this deduction is allowed for tax years ending prior to 1981* only);

d) Any consolidated dividends received deduction (computed in accordance with 26 CFR § 1.1502-26),

e) Any consolidated Section 247 deduction for dividends received from public utilities (computed in accordance with 26 CFR § 1.1502-27);

f) Any consolidating adjustments required due to the disposition of the stock of a subsidiary (computed in accordance with 26 CFR § 1.1502-11(b)(2)).

g) 26 CFR § 1.1502-21 allows a consolidated net operating loss deduction.

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For greater detail, refer to the 26 CFR section listed with each adjustment.

The amount of consolidating adjustments which are necessary and/or allowable to corporations filing a consolidated federal return are numerous and complex. In any situation in which the combined return group is made up of different members than the federal consolidated group, the applicability of these adjustments must be examined. It is also important to review the filing history of the combined return members to determine if the carryover provisions relating to the consolidated adjustments are in any way limited. The preceding explanation should be considered a general guideline for computing taxable income.

C. Banks for Cooperatives

The U.S. Supreme Court has ruled that a lending institution under the federal farm system consisting of banks for cooperatives is not exempt from state taxation. Refer to Chapter 30 for more information on financial institutions.

D. Federal 1120-F Filers

Federal taxable income for foreign corporations (federal 1120-F filers) is determined in accordance with IRC §§ 881 and 882 and generally includes only income connected with the conduct of the corporation's trade or business in the United States (rather than worldwide). Therefore, the amount of taxable income of a federal 1120-F filer, which would be included in unitary taxable income, would be limited to the amount which was reportable federally.

Federal taxable income to be used in computing Illinois base income is the sum of U.S. source fixed or determinable annual or periodic gains, profits, and income ("FDAP income") items reported in Section I of federal Form 1120-F (lines 1 -10, col. B), plus the amount of U.S. source income that is effectively connected with the conduct of a U.S. trade or business ("ECI") reported in Section II of Form 1120-F (Line 31). Addition and subtraction modifications would then be applied to determine total base income.

E. REMIC

Holders of Real Estate Mortgage Investment Conduits, (REMICs) are subject to the federal IRC provisions for REMICs. These provisions are a self-contained set of definitions and guidelines under IRC § 860A-G, when read as a whole, intend that federal taxable income would never be less than the excess inclusion income amount from such REMICS. (Refer to IRC § 860E(a)(1)). All members of an affiliated group filing a consolidated return are treated as one taxpayer for purposes of IRC § 860E. REMIC owners who report a federal loss on Line 28 prior to application of IRC § 860E must adjust their federal taxable income so as to not be less than the excess inclusion income amount. Excess Inclusion Income is

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calculated on federal Schedule Q for Form 1066 and reported on federal Form 1120, Line 30. Therefore, if federal Form 1120, Line 28 is lower than Line 30, it is a good indication that a REMIC adjustment has been made. Because Illinois follows federal taxable income, IL-1120, Line 1 will also include the excess inclusion income limitation. More information on REMIC related adjustments is available in Chapter 35, Losses.

F. Limited Liability Company / Disregarded Entity

Federal rules governing limited liability companies (LLCs) are in 26 CFR § 301.7701-3, classification of certain business entities. Illinois follows the federal rules on LLCs for filing purposes as explained in IAC § 100.9750(b).

1. LLC characteristics

   a) Owners are called members and may include:
      (1) Individuals
      (2) Corporations
      (3) Other LLCs
      (4) Foreign entities
   b) May have only one or up to an unlimited number of owners
   c) Owners have limited personal liability for debts & actions of the LLC
   d) Management flexibility
   e) Benefits of pass-through taxation

2. Businesses generally not eligible to be LLCs

   a) Banks
   b) Insurance companies
   c) Nonprofit organizations

3. Multiple-member LLCs

   a) Generally file as a partnership on Form 1065
   b) May file as a corporation
      (1) Must file Form 8832, Entity Classification Election

4. Single-member LLCs

   a) If bringing losses into the group,
      (1) See IAC § 100.4500 Carryovers of Tax Attributes paragraphs (a)(1)&(2)
   b) Member is an individual
      (1) File Form 1040
      (2) Schedule C, E or F

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c) Member is a corporation
(1) File Form 1120 or
(2) File Form 1120S

V. FEDERAL RARS

IITA § 506(b) requires that any changes affecting federal income tax (income, deductions, liability, credits, etc.) be reported to the Department within 120 days after the final determination is made or 2 years and 120 days if seeking a refund.

This provision allows the Department to assert a deficiency only for the underpayment that is attributable to the federal change. As a general rule, the correct amount of income, deductions, credits and resulting liability should always be computed correctly in order to ensure that any items carried to other years are correct and to ensure that the taxpayer does not receive a refund when it has not actually overpaid its liability and is not required to pay more tax when it has already paid its actual liability in full. To reconcile these two principles, the auditor should compute the taxpayer's correct liability (including the federal changes) and its correct liability (ignoring the federal change), and issue a notice of deficiency only for the excess of the correct liability over the taxpayer's total payments or the excess of the correct liability over the liability computed ignoring the federal change, whichever is smaller. In the case of a refund, the allowable refund cannot exceed the taxpayer's overpayment, computed using its correct liability, or the excess of its liability computed by ignoring the federal change over its correct liability, whichever is smaller.

For example, a taxpayer who failed to report an item of business income on its federal income tax return may be required to increase both its base income and its sales factor to properly take into account the unreported income.

Any reclassification of the amount of income classified as business or nonbusiness income and/or verification/adjustment of the allocation or apportionment methods is limited to the amount of the federal change in a situation where these federal changes result in additional tax due to the state.

For instance, if the statute of limitations for issuing a Notice of Deficiency on the original return has expired and the company has a federal change that increases income, as in the example below, the Department has the authority to examine and classify the federal audit increase as business or nonbusiness in nature and properly allocate that increase. However, the Department does not have the authority, in this situation, to recompute the apportionment formula of a company that originally filed on a separate company basis by determining that the company should have been filing as part of a unitary group. The classification of income, allocation or apportionment reported on the original return had to have been examined and

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adjusted within the statute of limitations time period for the original return. REF: *Caterpillar Tractor Co. v. Lenckos*, 1979 (See Chapter 49 for a synopsis of this case and a complete case citation.)

> Example: Corporate taxpayer timely files a 2004 Illinois return reporting federal taxable income of $100,000. There are no modifications or partnership income involved and all income is classified by the taxpayer as business income. The company reports a 50% Illinois apportionment formula, which results in a tax liability, originally computed on Illinois base income of $50,000. Had the return been audited by the Department it would have been determined that $10,000 of income should have been classified as nonbusiness income and allocated entirely to Illinois. The "correct" Illinois base income would have been $55,000 ($90,000 x 50% = $45,000 + $10,000 = $55,000).
>
> In 2007, as a result of a federal audit, federal taxable income was increased to $150,000. The taxpayer reports the federal change on an amended return and continues to treat all income as business income. The Illinois base income figure is increased to $75,000 ($150,000 x 50% = $75,000).
>
> Upon examination by the Department it is determined that of the $150,000 in revised federal taxable income, $40,000 is actually nonbusiness in nature ($10,000 of the original $100,000 and $30,000 of the federal change amount) and should be completely allocated to Illinois. Based on IITA § 905(e) the Department has the authority to propose an assessment based on reclassifying the $30,000 of the federal change amount as nonbusiness income and allocating it entirely to Illinois; however, it cannot reclassify the original $10,000 of income which should have been considered nonbusiness income on the original return since the statute of limitations had expired for issuing a notice of deficiency on that change. The Department would therefore have the authority to propose an assessment based on revised Illinois base income of $90,000 ($150,000 - $30,000 = $120,000 x 50% = $60,000 + $30,000 = $90,000).

IAC § 100.9200(a)(4) gives the procedures for reporting a federal change. This regulation also provides guidance on when a federal change (RAR) is considered finalized for reporting purposes under IITA § 506(b).

A. Taxpayer Informs the Auditor There Is a Finalized RAR,

or that an RAR may be finalized soon.

1. Auditors may not accept the following to incorporate finalized federal adjustments into their audits.
   a) a copy of the federal RAR

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b) IRS settlement
c) the taxpayer's workpapers

2. Auditors must instruct the taxpayer to report all finalized federal changes on the form prescribed by the Department (IL-1040-X, IL-1120-X, etc.).

3. Auditors are to advise the taxpayer, in writing, to file an amended return within 120 days of IRS finalization date and to pay the additional tax due, if any, to avoid late-payment penalties.

Simply informing the auditor that there is an RAR without providing a processable amended return does not comply with the 120-day statute for notification in order to avoid the underpayment penalty or with the requirement that a refund claim be filed within 2 years and 120 days after federal finalization.

Where the taxpayer has reached a finalized partial settlement/agreement with the IRS on one or more (but fewer than all) issues resulting in a change to base income, it is the Department's position that the taxpayer should report the agreed portion within the appropriate time period stated by IITA § 506(b).

IAC § 100.5030(a) states that if a company is a member of a federal consolidated group and the consolidated return is adjusted, any member whose "separate taxable income" is altered by the federal adjustment and who files an Illinois separate company return must report the adjustments as if the company had filed a separate federal return. If the company is a member of a unitary business group, any adjustments to the federal consolidated return that affects unitary income must be reported even if the actual federal adjustment was made to the income or expenses of a company that is not itself an Illinois filer. Since its income is a component part of the unitary income, any adjustments to that income must be reported.

B. Procedures for Handling RAR's

If the auditor is at the taxpayer's location, the taxpayer should give the amended returns directly to the auditor to expedite handling. A return is considered officially filed with the Department on the date it is presented to an auditor because he/she acts as an agent of the Department. The two-year statute of limitations to issue a Notice of Deficiency also commences to run on the "received date" of the return [IITA § 905(e)]. An executed Form IL-872 may be obtained to extend the statute of limitations on a federal RAR if necessary. Refer to Audit Manual chapter 39 for procedures on proper handling of RAR amended returns.

C. Expanding the Audit

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If the federal change encompasses tax years within or adjoining the audit assignment

- Be cognizant of the statute of limitations and prepare any necessary Form IL-872.
- Discuss the matter with your supervisor, who will approve and make the necessary changes to the period and statute on GenTax.
- If the federal change year(s) is outside of the audit period or involves tax years preceding the audit period, complete Form SC-137 to request a new assignment.
- Refer to Chapter 20 of the Audit Manual for procedures

VI. FEDERAL SCHEDULE J ADJUSTMENTS

As a result of changes made to IRC §§ 453(j) and 453C by the Tax Reform Act (TRA) of 1986, taxpayers may compute federal income tax on items of income which have not been included in federal taxable income ("Schedule J adjustments"). The Department has taken the position that the Schedule J adjustments should be included in federal taxable income for Illinois income tax purposes.

The Illinois effect of the 1986 amendments to the IRC is that federal tax may be paid on deemed payments but, since some taxpayers compute the tax as a Schedule J adjustment only, the deemed payments may never be included in the computation of federal taxable income. In addition, future actual installment payments may be included in federal taxable income net of the prior reported deemed payments. The result is that, unless an adjustment is made to reported federal taxable income, a portion of the gain or income from an installment sale may never be included in income for Illinois income tax purposes.

Taxpayers may take the position that the income has not been included in federal taxable income and cannot, therefore, be included in Line 1 of the Illinois return. However, IITA § 203(e)(1) states that taxable income is that which is "properly reportable" under the Internal Revenue Code and Schedule J adjustments are included in taxable income. The reason these items are not included in taxable income as shown on the first page of the federal return is that they are subject to tax at the highest marginal rate, regardless of the taxpayer's income. See, for example, IRC § 197(f) and IRC § 1291. To implement these provisions, the federal Schedule J computes tax on the taxpayer's income without regard to these items and then adds in an amount of tax on these items, computed at the highest statutory rate. Even though the taxpayer may have elected to calculate the tax effects of the TRA of 1986 adjustments on Schedule J and not include the income in Line 30 of the federal return, the income is still "properly reportable" taxable income and is, therefore, includible in the computation of Illinois net income.

Auditors must review the federal Schedule J to determine if there is tax calculated on income that is not reported in federal taxable income on page one of the return. Care should be taken in examining statements submitted to verify information reported on the "Other" line (9f on the

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2012 Form 1120) of the Schedule J. Once determined, the auditor will ensure the Schedule J income is properly reported for Illinois purposes.
If the auditor finds Schedule J income has not been properly reported for Illinois purposes, they must extensively document their findings and submit a request for Illinois Line 1 change approval to their supervisor. Supervisors will forward Line 1 audit adjustment requests to the Income Tax Audit Planning and Technical Support supervisor for review.

VII. ADDITION MODIFICATIONS

A. Federally Tax-Exempt Interest

(IITA § 203(b)(2)(A))

Interest excluded from gross income in the calculation of taxable income, and after December 31, 1987, all distributions from regulated investment companies are required to be added back to federal taxable income.

Any federally-exempt interest is required to be reported on the US 1120, Schedule M-1. It should appear on Line 7 (based on the 2012 form) of that schedule. The amount may also be verified by looking at the federal Schedule K, Line 9.

The addition modification is not limited to, but will primarily consist of, state and municipal interest income. The interest must simply be exempt from federal taxation. A distinction must be made between interest which is exempt from federal taxation and that which is beyond the reach of federal taxation (i.e. foreign source income not effectively connected with the United States). An example of this latter type of interest is the interest elimination, which would appear on the Schedule M-1 of a US 1120F filer.

The figure appearing on Line 7 may or may not be netted by amortization of bond premium (discussed next). It is important, when examining this interest, to research additional schedules and documents provided by the taxpayer to determine exactly what is included in this figure and to determine if the proper amount of interest recorded on the books is identified as such on the Schedule M-1.

Another type of interest, which should be included in the addition modification amount, is ESOP (Employee Stock Option Plan) interest. IRC § 133(a)(1) allows a certain percentage of this income to be excluded from the computation of federal taxable income. The amount of interest excluded should be added back to Illinois base income by virtue of IITA § 203(b)(2)(A).

Some interest, which is exempt from federal taxation, has also been exempted from Illinois taxation. See IAC §100.2470(c) and (f) and Publication 101 for a complete listing of these obligations. Since the income is not included in federal taxable income, it must first be added back to Illinois pro forma income before it can be claimed as a subtraction

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modification on the line for U.S. government interest. For information on subtraction modifications, refer to Chapter 25.

Any accrued interest, which is paid by the taxpayer to the seller when a bond is purchased between interest payment dates is interest income of the seller, and so is deducted from the amount of interest the taxpayer is considered to have earned for the year, and only the remaining amount of interest income is added back for Illinois purposes.

If, due to the amount of "paid for interest" or amortization of premium, the federally-exempt interest addition modification is a negative number, it should be shown as a positive subtraction modification (and properly identified as such) on the Other Subtraction line of the IL-1120.

The amendment enacted by Public Act 85-731 which changed the addition modification to include all distributions from regulated investment companies (RIC), requires corporations (for years ending on or after December 31, 1987) to add back any interest or dividends received from mutual funds investing in federally tax-exempt securities. If a stock dividend is received, the fair market value of the stock dividend on the date of distribution must be included in Illinois base income. If, however, the distribution is actually a "return of capital" which is tax free for federal purposes, the distribution would also be tax free for Illinois purposes.

Illinois taxes zero coupon municipal bond interest as it is accreted each year. For more information regarding the accretion of discount, refer to number two below, Accretion of Discount section.

1. Amortization of Bond Premium

Bond premium is the amount a purchaser pays for the bond, which exceeds the bond's face value. When a bond sells at a premium, it is generally because the interest it bears exceeds the rate of return on similar securities in the market at the time of the sale. Because of this, the purchaser pays a "premium" price for the bond over its face value. The interest received on the bond each period is taxable to the purchaser/owner. The amount of interest received, however, is not the bond's true yield since a portion of that interest is actually a return of the premium paid. Under IRC § 171, the owner of a federally taxable bond may offset the interest income it must include in taxable income each year by the amount of that income which is actually the return of premium. This is known as amortization of the bond premium. The basis of these bonds is also reduced each year and when the bonds are ultimately sold (whether federally taxable or tax-exempt) the capital gain or loss is computed on the adjusted basis of the bonds.

The IITA allows taxpayers to subtract the bond premium amortization required by IRC § 171 for that year to the extent the taxpayer was prohibited from deducting the

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amortization by IRC § 171(a)(2). Illinois does not provide any adjustment to federal taxable income (adjusted gross income in the case of an individual) related to gains or losses on the sales of bonds. The only subtraction is for the amortization of bond premium that is allocable to that particular tax year. If the bond is called before maturity, then there is no subtraction for periods after the call date.

Although IAC § 100.2455(b) is for subtraction modifications, the taxpayer could net bond premium amortization against the addition modification for state and municipal interest. The instructions to the IL-1120 state that the addition modification should match Schedule M-1, Line 7 (or equivalent). The interest reported on the M-1 could be gross or net of premium amortization. If it is gross, then the taxpayer would claim the premium amortization as a subtraction modification and include it on the Illinois Schedule M.

2. Accretion of Discount

a) Original Issue Discount

If a bond is acquired from an issuer for an amount that is less than the maturity value, the issuer will have to pay the difference between the selling price and the maturity value to the holder of the bond when the bond matures. The difference between the selling price and the maturity value is known as Original Issue Discount (OID). Under federal law, if the interest from the obligation is taxable federally, the holder of the obligation that was issued with the OID must include a portion of the OID in gross income each year even though the OID is not paid until maturity. For some exceptions to this federal rule, refer to IRC § 1272.

For Illinois purposes, the holder of the obligation should increase the addition modification claimed for interest income earned on the federally tax-exempt bonds by a pro rata amount of the OID if, had the obligation been taxable federally, the holder would have had to report it as such on the federal return.

b) Market Discount

If a bond is acquired from someone other than the issuer at a discount, the difference between the acquisition amount and the maturity value is known as a market discount. A market discount on obligations issued after July 18, 1984 whose interest is taxed at the federal level is not taken into consideration until the bond matures or is sold. At that time, the amount of the gain reported which is attributable to the market discount is considered ordinary income and taxed as such. Therefore, for Illinois addition modification purposes, any accretion of market discount is not included in the modification amount until the bond has matured.

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3. Insurance Company Interest Federally Exempt

(IITA § 203(b)(2)(A))

Refer to Chapter 31 for information regarding the computation of the addition modification for federally tax-exempt interest when dealing with insurance companies.

B. Illinois Income and Replacement Tax Deducted

(IITA § 203(b)(2)(B))

As a general rule, the amount of Illinois Income Tax deducted on the federal return (US 1120, Page 1, Line 17) for the year is the amount of the Illinois addition modification (Step 2, Line 4 on the 2012 IL-1120). A state by state breakdown of the Line 17 amount showing, specifically, the amount of Illinois income and replacement (if applicable) tax deducted should be included in the audit file. In some cases where there has been subsequent payments made to an account for a specific year (due to billings, amended returns, state or federal audits, etc.), the additional tax expense might be claimed on the Other Deductions line of the federal return.

If the corporation is using the accrual method of accounting in preparing their federal tax return, the state income tax deduction is an estimate. It is possible and very likely, that in a subsequent year it will be determined that the amount of state taxes was over or under accrued for a prior period. An adjustment for the over/under accrual is then made to the deduction computed in the later year. The accrual adjustment should be reflected in the Illinois modification in the later year also. In some cases, this may result in a negative addition modification. Since a negative addition modification cannot be processed, it should be shown as a positive subtraction modification, and reported (with a proper explanation) on the Other Subtraction line of the IL-1120.

Also see IAC § 100.2450 IIT Refunds

C. Capital Gains Addition

(IITA § 203(b)(2)(C))
FOR REGULATED INVESTMENT COMPANIES (“RICs”)

A RIC's computation of federal taxable income (US 1120-RIC) does not include capital gain income. The computation of capital gain income and the deduction for dividends paid to shareholders is done on US Schedule D (Form 1120), line 17, and reported in part two of the US 1120-RIC (after the computation of federal taxable income). Based on IRC § 852(b)(3), the excess of capital gain income over dividend distributions to shareholders has not been included in federal taxable income, thus, the need for the addback required under IITA § 203(b)(2)(C).

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D. Net Operating Loss Deduction After 12/31/86

(IITA § 203(b)(2)(D))

This section requires taxpayers to add back the amount of net operating loss deducted in arriving at taxable income unless carried forward from a tax year ending prior to December 31, 1986.

Refer to Chapter 35 for information regarding the computation of the Illinois Net Loss Deduction.

E. Net Operating Loss Carried From Before 12/31/86

IITA § 203 (b)(2)(E)

In general, this modification states that taxable income may be less than zero (but not less than the NOL for the year) provided that when taxable income is less than zero, and addition modifications exceed subtraction modifications, an NOL addition modification must be made for any taxable year to which the NOL is applied.

Net operating loss deductions are reported on US 1120 line 29a and carried to Step 2, Line 2 on the IL-1120. For information regarding Net Operating Losses, including the related modifications, refer to Chapter 35.

F. Remediation Costs Addition

(IITA § 203(b)(2)(E-5))

This modification applies to taxpayers who, for tax years ending after December 31, 1997 and on or before December 30, 2001, claimed a credit for unreimbursed environmental remediation costs.

The credit was calculated on Schedule 1299-D and reported in Part V on the Form IL-1120. The addition modification was reported in Part I on the Other Additions line of the Form IL-1120. The taxpayer is required to have a “No Further Remediation” letter that was issued by the Illinois Environmental Protection Agency (IEPA) to justify the credit and subsequent addition modification. The credit had to have been claimed for the taxable year in which the IEPA approval of the eligible costs was granted.

For more information on Income Tax credits, refer to Chapter 36 of the Audit Manual.

G. Federal Bonus Depreciation

(IITA § 203(b)(2)(E-10))

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The auditor's primary responsibility will be to verify that the taxpayer does not claim too much in subtraction modifications on bonus depreciation previously reported as an addition modification. However, it is advised that the addition modification, if reported, be verified as well. For information regarding the bonus depreciation subtraction modification, refer to Chapter 25.

IRC § 168 originally provided that taxpayers were to deduct bonus depreciation of 30% of the cost of capital assets acquired and placed in service after September 10, 2001, and before January 1, 2005. Taxpayers depreciate the remaining 70% of the cost using their normal depreciation method. For most assets, the normal depreciation is 70% of what the amount would be if no bonus depreciation were claimed. The bonus depreciation allowable on property placed in service after May 3, 2003, increased to 50%.

IRC Section 168(k) has been amended several times through the following Acts, primarily to extend its application.

- Economic Stimulus Act of 2008
- American Recovery and Reinvestment Act of 2009
- Small Business Jobs Act of 2010
- American Taxpayer Relief Act of 2012
- Tax Increase Prevention Act of 2014
- Protecting Americans from Tax Hikes (PATH) Act of 2015

The most recent amendments reflect the intention of Congress to provide for bonus depreciation rules that are substantially identical to the bonus depreciation rules originally enacted in 2002 and 2003. A comprehensive set of regulations were promulgated in connection with the former rules. *See* 26 CFR § 1.168(k)-0 *et. seq*. The IRS in 2008 issued a notice confirming that the existing regulations continue to apply. See IRS News Release (IR-2008-58) (April 11, 2008).

Federally, bonus depreciation has generally been available since September 11, 2001, with a period of expiration in 2005, 2006, and 2007, and has ranged from 30 percent to 100 percent over the years as shown in this chart:

Start Date	**End Date**	**Bonus Rate**
09/11/2001	05/05/2003	30%
05/06/2003	12/31/2004	50%
01/01/2008	09/08/2010	50%
09/09/2010	12/31/2011	100%
01/01/2012	12/31/2017	50%
09/27/2017	12/30/2022	100% for qualifying assets

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Public Act 92-603 effective June 28, 2002, “decoupled” Illinois from the federal legislation by reversing its effects on depreciation.

- First, it requires taxpayers to add back on their Illinois return, the federal bonus depreciation.
- Second, it allows taxpayers to deduct the depreciation amount that would have been allowed on their federal return if the bonus depreciation law had not been enacted.
- This deduction is allowed for each year that depreciation is claimed for an asset, not just for the year in which the bonus depreciation on the asset is added back.

For most taxpayers, the bonus depreciation for "listed property" such as automobiles used in business is claimed in Part V of federal Form 4562. For all other property, most taxpayers claim the bonus depreciation in Part II, of the Form 4562. The amount of the bonus depreciation is then subtracted from the cost basis of the property, and the net amount is used to compute regular depreciation in column (c) of Line 19 or Column (e) of Line 26 of the 2012 form. The instructions indicate that the bonus depreciation is computed on the cost basis of the property, minus any IRC § 179 deduction claimed with respect to that property, for both Lines 14 and 25.

All deductions taken on US Form 4562, Part II, Lines 14 and 25 must be added back as an addition modification. Auditors will refer to these sections of the form to verify amounts reported for Illinois.

As initially enacted, the modification in IITA § 203(b)(2)(T) assumed that the taxpayer had actually taken bonus depreciation equal to 30% of its basis in the property, so that its regular depreciation is computed on only 70% of the basis it would otherwise use. The depreciation deduction is therefore equal to 70% of what it would be if IRC § 168(k) had not been enacted. Multiplying the 70% times 0.429 gives 30% which is the reduction in regular depreciation caused by taking the bonus depreciation. However, the amounts on Line 19 of Form 4562 also include depreciation on other property, so we cannot simply multiply those amounts by 0.429 to compute this adjustment. Auditors will review a breakdown of all items listed for Line 19 to determine on which bonus depreciation was claimed.

H. Bonus Depreciation - Effect on Federal Gain & Loss

(IITA § 203(b)(2)(E-11))

Under the IRC, the gain or loss realized by a taxpayer on the disposal of a depreciable asset is the sales price minus the depreciated basis. Thus, if the depreciation deductions taken over the life of an asset exceeded its actual decline in value, the taxpayer will realize a gain on its sale, recapturing the excess depreciation. If the depreciation was less than the decline in value, the taxpayer will realize a loss on the sale. Either way, the total of all depreciation

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expenses plus the loss (or minus the gain) realized on the sale will equal the actual decline in value of the asset.

If not for subsections (E-11) or (U), the Illinois accounting for the decline in value of an asset would be wrong unless the asset was fully depreciated prior to the sale. Only then would the total subtractions allowed in subsection (T) offset the addition required in (E-10), so that the Illinois depreciation would equal the federal depreciation, and the federal gain would equal the gain that should be recognized for Illinois purposes. At any other time, the depreciation effectively allowed for Illinois purposes would be less than the depreciation allowed for federal purposes, and the federal gain flowing through to Illinois would be greater than the gain that a taxpayer should realize (or the federal loss would be less than the proper Illinois amount).

With subsections (E-11) and (U) reversing all the Illinois adjustments, the total depreciation allowed for Illinois purposes will be the amount allowed for federal purposes, and the net gain or loss recognized federally and passed through to the Illinois return is exactly what the gain or loss should be for Illinois purposes. The taxpayer is required to make this addition modification only once under this subparagraph with respect to any one piece of property.

Form IL-4562 is used to compute the addition and subtraction modifications for the bonus depreciation. The form must be attached to the Illinois return. If the Illinois tax return has already been filed, then the taxpayer must file an amended return. The IL-4562 must be attached to the amended return. Auditors should review the IL-4562, Step 2, Line 3 for accuracy and request any other documentation necessary to make a determination.

If an amended return reversing the bonus depreciation was filed by October 15, 2002, no penalties or interest were assessed on the resulting underpayment.

1. IL-1040 Filers

The computation of the Federal Bonus Depreciation addition and subtraction modifications can be different for IL-1040 filers because some individuals report their depreciation expenses on federal Form 2106 for Employee Business Expenses. Refer to Chapter 45 for more information on Individual Income Tax audits.

2. Expiration of the Federal Bonus Depreciation

The Federal Job Creation and Worker Assistance Act of 2002 that created bonus depreciation expired in 2004. However, there have been several other Acts extending the provisions of IRC § 168(k). The most recent Act passed relating to federal bonus depreciation has extended the provision through tax year 2026. Unless a new Act is

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ratified further extending the federal bonus depreciation, there will be no addition modifications after 2026; subtraction modifications will continue in succeeding years. See the example below following the next issue.

3. Federal Bonus Depreciation at 50%

The federal bonus depreciation started out at 30% for assets placed in service on or after September 11, 2001. The percentage increased to 50% for certain assets acquired after May 5, 2003. Public Act 94-776 amended the IITA for tax years ending after December 31, 2005, to allow the subtraction of 100% of the federal depreciation deduction of an asset on which 50% bonus depreciation was claimed.

The following example illustrates how property acquired between May 5, 2003 and December 31, 2005 will be handled.

> Example: As a result of the disallowance of the 50% Federal bonus depreciation, an asset for Illinois purposes will not get the full depreciation deduction over its life because of the 3/7 (.429) factor applied to the remaining federal deprecation not including the bonus depreciation. In the example below a $10,000, 5-year asset purchased in 2004 gets a 50% federal bonus depreciation deduction of $5,000 = ($10,000 x 50%) plus regular federal depreciation of $1,000 = ($5,000 x 20%) in 2004. For Illinois, the $5,000 bonus is added back to income and 3/7 of the regular federal depreciation, or $429 = ($1,000 x .429), is allowed as a deduction in 2004.

	Add-back	Subtraction	
2004	5,000	429	($5,000 x 20% x .429)
2005	0	1,600	($5,000 x 32%)
2006	0	960	($5,000 x 19.2%)
2007	0	576	($5,000 x 11.52%)
2008	0	576	($5,000 x 11.52%)
2009	0	288	($5,000 x 5.76%)
Total	5,000	4,429	

Under current law, there is no deduction for the remaining $571 in basis. However, all addition and subtraction modifications are reversed in the year the asset is disposed of, so over the life of the asset the taxpayer will be allowed to deduct the entire basis of the asset, either as depreciation or in determining the gain or loss on disposition.

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I. Related Party Expenses

(IITA §§ 203(b)(2)(E-12) and (E-13))

Public Act 93-0840 created new addition and subtraction modifications for related party transactions with 80/20 companies effective for taxable years ending on or after December 31, 2004. Originally the new modifications only applied to interest and intangible expenses incurred in transactions with related companies that would have been included in the unitary group if not for the 80/20 rule. Later, Public Act 95-0233 and Public Act 95-0707 for taxable years ending on or after December 31, 2008 expanded the modifications to include interest expenses, intangible expenses and insurance premium expenses incurred in transactions with a related party foreign or domestic that would have been a member of the unitary group if not for the prohibition in IITA § 1501(a)(27) that requires all members of the unitary group to apportion their income under the same subsections of IITA § 304 (noncombination rule). Schedule 80/20, Related Party Expenses, was revised along with IAC § 100.2430, Addition and Subtraction Modifications for Transactions with 80/20 and Noncombination Rule Companies. Effective for tax years ending December 31, 2017 and after, Public Act 100-0022 amended the IITA in a manner to affect related party addition and subtraction modifications by eliminating the aforementioned noncombination rule.

Related party expense modifications are reported on the IL Schedule 80/20. It is possible that a parent company is 100% foreign and not incorporated in the US. Auditors will review the schedule and any supporting documents to verify the modifications are calculated correctly.

1. 80/20 Company Specific Modifications

The addition and subtraction modifications relate to all taxpayers including individuals, corporations, trusts & estates, and partnerships that own or transact business with 80/20 companies starting with taxable years ending on or after December 31, 2004. Schedule 80/20 Related-Party Expenses was created for taxpayers to report these modifications. The Schedule 80/20 Related-Party Expenses is for corporations (including Subchapter S corps), trusts & estates and partnerships. Individuals report the addition and subtraction modifications on Schedule M.

Note: For individuals, corporations, trusts & estates, and partnerships the legislation created two addition modifications and three subtraction modifications each for a total of 20 new addition and subtraction modifications to the Act.

The addition modifications are for interest expenses (IITA § 203(b)(2)(E-12)) and intangible expenses (IITA § 203(b)(2)(E-13)) incurred in transactions with a person who would be a member of a unitary business group with the taxpayer, if not for the 80/20 test. This is for interest expenses and intangible expenses, including royalties, that reduced

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federal taxable income or federal adjusted gross income reported to Illinois. These additions are included on Schedule 80/20, Step 2, Lines 3 and 6; however, these amounts in Step 2 are reduced by any dividend income received from the 80/20 company that is included in Illinois base income. A dividend is included in base income only to the extent that it is neither deducted from federal taxable income or adjusted gross income, nor claimed as a subtraction modification under IITA § 203. See IAC § 100.2430(b)(1) for more information.

In the simplest tax-reduction scheme, the U.S. corporation creates an 80/20 subsidiary, contributes a large amount of cash to the subsidiary, and borrows the cash back. After that, the U.S. corporation pays interest to the 80/20 subsidiary and deducts the interest payments on the federal return, thereby reducing its Illinois taxable income. The 80/20 subsidiary is typically set up in a foreign "tax haven" such as the Bahamas, where Illinois has no authority to tax it on its interest income and the foreign government does not tax it at all. The 80/20 subsidiary returns the cash it receives to the U.S. corporation either as new loans or as dividend payments, which are at least partially exempt from Illinois tax and usually are entirely exempt. At the end of all these transactions, the U.S. corporation has all the cash it started with but has created federal deductions to reduce its Illinois tax liability.

Example:

Calendar Year 2004 Description	Domestic Parent	Virgin Islands Co
Line 1 Sales	12,000,000	
Dividend income from 80/20	2,000,000	
Royalty Income		1,000,000
Interest Income		1,000,000
Total Income	14,000,000	2,000,000
Wages	4,000,000	
Depreciation	500,000	
Royalty Expense paid to 80/20	1,000,000	
Interest Expense paid to 80/20	1,000,000	
Other Expenses	2,500,000	10,000
Total Expenses	9,000,000	10,000
Federal Line 28	5,000,000	1,990,000
Sch C dividend exclusion	2,000,000	
Federal Line 30	3,000,000	1,990,000

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In this example, the domestic parent owns a subsidiary in the Virgin Islands that is incorporated in Delaware, so the subsidiary is included in the consolidated federal return as indicated above. The auditor does an 80/20 test on the Virgin Islands subsidiary and determines that it is excluded from the unitary group under IITA § 1501(a)(27). The parent has transferred substantial capital to the 80/20, which it has borrowed back resulting in a $1 million interest payment to the 80/20. The interest income appears on the pro forma federal return for the 80/20 with the income being excluded from unitary income; however, the corresponding interest expense has reduced Illinois unitary income. In addition, the parent has transferred intellectual property to the 80/20 and pays the 80/20 royalty expenses of $1 million for the use of the intangible property.

In return, the 80/20 has paid the domestic parent a dividend of $2,000,000, which was eliminated from federal taxable income as a federal dividend exclusion. Therefore, the dividend income is not included in Illinois base income.

On Schedule 80/20 for 2004 the $1,000,000 in interest expense and $1,000,000 in royalty expenses paid to the 80/20 are reported in Step 2, Lines 3 and 6 respectively. Since all of the $2,000,000 in dividend income received from the 80/20 was excluded from federal taxable income reported on the Illinois return, the dividend income is not in Illinois base income and therefore not included on Schedule 80/20, Step 2, Line 4. This would be the same result as if the dividends were included in Illinois federal taxable income, but deducted on Illinois Schedule J. The effect of the additions is to increase Illinois base income by the $2,000,000 in interest and royalties paid to the 80/20.

If the taxpayer failed to prepare the Schedule 80/20, then the auditor should prepare the Schedule 80/20 to assure that the audit schedule is computing the correct amount of additions and subtraction modifications.

Note: Because this is a tax year ending prior to December 31, 2008, if the 80/20 company is a one-factor financial organization and the domestic parent is a three-factor company that apportions its income under IITA § 304(a), the addition modifications on Schedule 80/20 will not apply because the 80/20 company would not be a member of the same unitary business group as the parent even if it failed the 80/20 test for exclusion from the group.

Example: A unitary transportation group that apportions its income under IITA § 304(d) creates an 80/20 company in 2007 in a foreign country with $1 billion in capital. The 80/20 then loans money to the transportation group and in 2007 received interest of $50 million. The unitary group deducts the interest paid to the 80/20, but the income received by the 80/20 is not subject to Illinois tax. Since the 80/20 company is not a transportation company, it cannot be included in the unitary group even if it was not an 80/20 and therefore the transaction is not subject to the Schedule 80/20 modifications in 2007. However, for tax years ending on or after December 31, 2008 and prior to

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December 31, 2017, Schedule 80/20 would be applicable because of the expanded rules that applied to noncombination rule companies.

J. Captive Insurance Companies

(CURRENT IITA § 203(b)(2)(E-14))

Starting with tax years ending on or after December 31, 2008 and prior to December 31, 2017, the addition modifications on Schedule 80/20 include insurance premium expenses that are paid to an insurance company excluded from the unitary group because of the noncombination rule. Consequently, the insurance company must be at least 51% owned (captive insurance company) so that it could qualify for inclusion in the unitary business group if it were not for the noncombination rule. For tax years ending December 31, 2017 and after, Public Act 100-0022 discontinued the noncombination rule found in IITA § 1501(a)(27)(B).

Refer to Chapter 31 for information regarding the computation of the addition modifications for insurance companies.

1. Exceptions to the Use of Schedule 80/20

There are five provisions, commonly referred to as "safe harbor provisions" which if met, would make the Schedule 80/20 inapplicable to the transaction involving interest or intangible expenses. There is no safe harbor provision applicable to insurance premiums. The safe harbors in IAC § 100.2430(c) are basically the same for both interest and intangible expense as defined in IAC § 100.2430(b). Also, see IAC § 100.2430(c) for more information.

a) Tax Paid in a Foreign Country or State

The Department's position is that foreign or other state tax returns:

(1) must show a tax liability based on the interest or intangible expenses that relate to the 80/20 transaction
(2) taxpayer should actually be paying the tax rather than accruing the tax
(3) cannot be based on a minimum flat-rate tax
(4) cannot be just an informational return.

If the foreign tax return is in a foreign language, the auditor will need to request that copies, translated to English, be provided, including form instructions and any supporting documents. The purpose of reviewing foreign tax returns for the payment of tax is to see if Illinois's addition modification on the interest or intangible expenses creates any double taxation between Illinois and the foreign country. If the auditor is

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not satisfied with the documents provided, acting as an authorized agent of the Department, they may request more information as necessary to determine if what was provided was clear and convincing evidence and validates the taxpayers claim. When translated tax returns are not available, all three of the following would be necessary to document foreign tax was applied to the interest or intangible expenses:

- Form 8833
- An independent, third party description of the tax requirements in the foreign country
- An affidavit from the tax manager or similar officer that all filing requirements were met

Problems may arise when Form 8833 is not filed. In that case, it may be acceptable to obtain a letter from the taxing authority verifying that the interest or royalties from the US affiliate were included in taxable income. Any documentation provided by the taxpayer as support for this safe harbor exemption must be submitted to Audit Technical Support to be approved by Legal.

If the taxpayer will not comply, the auditor should make the appropriate adjustments.

If a taxpayer is not required to file in a foreign country because of an international treaty, the taxpayer is not taxable in that foreign country under IAC § 100.3200(a)(2) and the sale is subject to throwback. However, that regulation applies to whether a taxpayer is deemed "taxable" for purposes of apportionment and nonbusiness income, not for purposes of the 80/20 safe harbor provisions. The taxpayer must be "subject to tax", not merely "taxable" for 80/20 safe harbor, and as stated earlier, must be reporting and paying income tax in the foreign jurisdiction. So, whether the taxpayer does not file due to a treaty, or is "taxable" but not required to file and pay income tax in the foreign jurisdiction is irrelevant: it would not qualify for 80/20 safe harbor.

Both the Act and Regulations state that the foreign person or (prior to December 31, 2017), noncombination rule company has to be subject to tax in the foreign country or state, however this safe harbor does not apply in the case of a country or state in which the taxpayer and the foreign company or noncombination rule company are required to file unitary returns. The purpose of the safe harbor is to eliminate the Illinois addition modification if it will create a double taxation between Illinois and another state or country. Since transactions between companies required to be included in a unitary group are either eliminated in combination or a wash (i.e. the deduction allowed to the payor will offset the income of the recipient), the income is not actually subject to tax in the other state. The taxpayer will not qualify for the safe harbor provision because there is no double taxation between Illinois and the other state.

b) Arm's Length Transactions

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The taxpayer could claim that they engaged in an "arm's length" transaction with their affiliate. Illinois has no definition of an arm's length transaction; however, IITA § 102 provides that terms used in the IITA shall have the same meaning as when used in the same context in the IRC. There are IRC rules for arm's length transactions in 26 CFR § 1.482-1, Allocation of income and deductions among taxpayers.

It will be very difficult for the Department to argue the actual viability of an arm's length agreement (i.e. whether or not the terms equate to an arm's length agreement). Instead, the auditor should verify whether or not the terms of the agreement are being met.

If the transaction involves a loan or other agreement where substantial payments are being made, then there should be a signed agreement(s) between the parties.

(1) The auditor should verify that the parties are abiding by the terms specified in the contracts or written agreements.
(2) The auditor should list all of the provisions in the agreement and then check off which provisions the taxpayer is abiding by, and note any provisions the taxpayer is consistently in violation of.
(3) If the taxpayer is not abiding by the terms of its written agreements, then this would indicate that the transaction(s) is not arm's length.
(4) Also, while reviewing the transactions the auditor should note any of the following:
  (a) Are payments being made timely between the subsidiaries?
    (i) If the taxpayer is making only one payment under a contract every three to five years, then the contract is unlikely to be at arm's length.
  (b) Is the taxpayer actually making cash payments or are they just making debit and credit entries in their books?
    (i) Ask for bank statements to verify that payments are being made.
  (c) Are penalties being charged for any late payments or other violations as specified under the contract?
  (d) If the transaction involves floating interest payments, are fluctuations in the floating rate being adjusted in a timely manner?

c) Documentation

In most cases it will be difficult for the taxpayer to claim a safe harbor for payments made to an 80/20 company in a tax haven country, or an 80/20 company or for applicable years, noncombination rule company with little or no property or payroll. These are cases where the auditor should definitely challenge the taxpayer's assertion that the related party modifications do not apply.

However, the related party modifications can apply to transactions with any affiliate including a foreign parent. If there are substantial payments for interest and intangible

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expenses to an affiliate that would be unitary with the taxpayer but for the 80/20 test or prior to December 31, 2017, noncombination rule, and the affiliate is not taxed on the income, then the auditor should determine if the taxpayer engaged in a tax strategy to shift income off of its Illinois return because the safe harbor provisions do not apply if a principal purpose of the transaction was Illinois tax avoidance. This may require a review of historical information going back years before the audit period to see if there were substantial transfers of funds or intellectual property from the unitary group to the affiliated member outside the unitary group. If the taxpayer claims one or more safe harbor provisions, then the taxpayer must provide the auditor with proof that the safe harbor applies to the transaction(s).

The burden of proof is on the taxpayer and not the auditor to support any safe harbor claim. Auditors should not prepare workpapers to support any safe harbor claim made by the taxpayer, especially a claim that the transaction(s) is at arm's length since proving that can be very complex under rules set by the IRC.

[redacted] Nevertheless, the taxpayer must provide some proof that a safe harbor provision applies to the transactions. If the taxpayer will not supply any documentation, then the safe harbor claim should be disallowed.

Below is a list of items that the auditor could request, depending on the facts and circumstances. If there are dozens of transactions, then the auditor should test check the items.

- All written agreements setting up the questionable transaction(s) or tax plan. (For example: stock purchase agreements, credit agreements, licensing agreements, etc.)
- All written agreements evidencing any intercompany loans and payments.
- Any other documents (i.e., books and records, wire transfers, transaction slips, bank statements, journal entries, etc.) tracing the exchange of funds.
- Board of Directors meeting minutes, consents of the board of directors, and resolutions approving the arrangement in question.
- Accounting firm proposal, if any, explaining the arrangement to reduce/shelter taxes. (The accounting firm's pitch for the created tax plan).
- Any tax department interoffice recommendations or correspondence regarding the approval or ideas for the tax plan at issue.
- Any documentation evidencing the transfer of assets and cash to set up the arrangement (i.e., transfer of intellectual property to an 80/20 company, loans, etc.)
- A detailed balance sheet matching up expenses with income.

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Exhibits should be created documenting the auditor's findings. See IAC § 100.2430(c) for more information.

d) Economic Substance Doctrine

Although the economic substance doctrine is a provision of federal statute, auditors can utilize the guidelines it provides in making determinations of whether to allow certain modifications. We would apply the economic substance doctrine only for purposes of determining whether the taxpayer can meet one of the safe harbors that apply, only when tax avoidance is not one of the primary purposes of the transaction. The lack of economic substance is an indicator that a transaction was tax-motivated and thereby not allowable under statute. The most likely application of the doctrine will relate to taxpayers involved in transactions with 80/20 companies.

Section 1409(a) of the Health Care and Education Reconciliation Act of 2010 (the "2010 Act") codified a conjunctive economic substance test in new IRC § 7701(o). The new statute defines the economic substance doctrine as the common law doctrine under which certain tax benefits are not allowable if the transaction does not have economic substance or lacks a business purpose.

The statute states that "[i]n the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if—

(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and

(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction."

As a result, enactment of IRC § 7701(o) resolved the longstanding conflict among various circuit courts of appeal regarding how the doctrine should be applied by codifying a two-part conjunctive test.

(1) Analyzing a Transaction

The following facts and circumstances tend to show that application of the economic substance doctrine may be appropriate. Auditors need to utilize these guidelines to evaluate transactions in which taxpayers claim safe harbor to make the proper determination as to whether the transactions are valid for income tax reporting.

- Transaction is promoted/developed/administered by tax department or outside advisors
- Transaction is highly structured

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- Transaction includes unnecessary steps
- Transaction is not at arm's length with unrelated third parties
- Transaction creates no meaningful economic change on a present value basis (pre-tax)
- Taxpayer's potential for gain or loss is artificially limited
- Transaction accelerates a loss or duplicates a deduction
- Transaction generates a deduction that is not matched by an equivalent economic loss or expense (including artificial creation or increase in basis of an asset)
- Taxpayer holds offsetting positions that largely reduce or eliminate the economic risk of the transaction
- Transaction involves a tax-indifferent counterparty that recognizes substantial income
- Transaction results in separation of income recognition from a related deduction either between different taxpayers or between the same taxpayer in different tax years
- Transaction has no credible business purpose apart from tax benefits
- Transaction has no meaningful potential for profit apart from tax benefits
- Transaction has no significant risk of loss
- Tax benefit is artificially generated by the transaction
- Transaction is pre-packaged
- Transaction is outside the taxpayer's ordinary business operations.

The converse of the aforementioned circumstances tends to show that the application of the economic substance doctrine may not be appropriate. Also consider that transactions that generate targeted tax incentives, in form and substance, and are consistent with Congressional intent in providing the incentives, would not have the doctrine applied.

In addition, it is likely not appropriate to raise the economic substance doctrine if the transaction being considered is related to the following circumstances.

- The choice between capitalizing a business enterprise with debt or equity
- A U.S. person's choice between utilizing a foreign corporation or a domestic corporation to make a foreign investment
- The choice to enter into a transaction or series of transactions that constitute a corporate organization or reorganization under subchapter C
- The choice to utilize a related-party entity in a transaction provided that the arm's length standard of IRC § 482 and other applicable concepts are satisfied.

(2) Development of Case

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If after applying the guidance set forth above the auditor believes a transaction does not present characteristics of being eligible for safe harbor, the following series of inquiries should be evaluated before making adjustments to the applicable modifications.

- Is the transaction a statutory or regulatory election?
- Is the transaction subject to and in compliance with a detailed statutory or regulatory scheme?
- Does precedent exist (judicial or administrative) that either rejects the application of the economic substance doctrine to the type of transaction or a substantially similar transaction or upholds the transaction and makes no reference to the doctrine when considering the transaction?
- Does the transaction involve tax credits (e.g., low income housing credit, alternative energy credits) that are designed by Congress to encourage certain transactions that would not be undertaken but for the credits?
- Does recharacterizing a transaction (e.g., recharacterizing debt as equity, recharacterizing someone as an agent of another, recharacterizing a partnership interest as another kind of interest, or recharacterizing a collection of financial products as another kind of interest) more appropriately address the noncompliance that is being examined?

If the answer to any of the above is affirmative, the economic substance doctrine would not apply and adjustments should be made using other justification or disregarded altogether.

Examples are provided in the Exhibits section of this chapter.

K. Captive Real Estate Investment Trust (REIT)

(IITA § 203(b)(2)(E-15))

Public Act 95-0233, as amended by Public Act 95-707, created an addition modification for corporations effective for taxable years beginning after December 31, 2008, relating to a captive real estate investment trust (REIT). The definition of a REIT is found in IITA § 1501(a)(1.5). Since most REITs are calendar year filers, the effective date for most will be the calendar year 2009 IL-1120.

Under IITA § 1501(a)(1.5)(C), apply the constructive ownership rules in IRC § 318(a) as modified by IRC § 856(d)(5), for the more than 50% test. Note that under IITA § 1501(a)(1.5)(B) there are several exceptions to these provisions relating to captive REIT that are exempt under IRC § 501, foreign REITs and an “Australian property” REIT. See IITA § 1501(a)(1.5) for more information.

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The captive REIT addition modification is only for corporations (because REITS are taxed as corporations) and is reported in Step 2 of the business Schedule M. The purpose of the addition modification is to close a tax loophole where the captive REIT, which is a member of the unitary group, pays a dividend to a corporation, usually a REIT holding company that is not a member of the unitary group either because it meets the 80/20 test, or prior to December 31, 2017, because the REIT and the holding company apportion their income under different subsections of IITA § 304. When the REIT pays a dividend, it claims a federal dividends-paid deduction on Form 1120-REIT. This reduces federal taxable income reported by the REIT on its IL-1120 or the unitary group's Schedule UB. IITA § 203(e)(2)(D) defines REIT taxable income as "real estate investment trusts taxable income" which is line 22 of Form 1120-REIT (line reference based on 2012 federal form). The corresponding dividend income received by the REIT holding company is received outside the unitary group. However, there is nothing in the addition modification to suggest that it only applies if entities are excluded from the UBG. The new addition modification reverses the federal dividends-paid deduction in the computation of Illinois base income.

Example

	PER US 1120s			
Description	2009 Domestic Parent	REIT Chicago	REIT Holding Co Bahamas	2009 Total for All Companies
Dividend Income	700,000	0	29,676,000	30,376,000
Interest Income	168,000,000	31,000,000	1,000	199,001,000
Other Income	105,000,000	0	0	105,000,000
Total Income	273,700,000	31,000,000	29,677,000	334,377,000
Salaries & Wages	51,500,000	12,000	4,500	51,516,500
Rent Expense	400,000	12,000	24,000	436,000
Interest Expense	70,000,000			70,000,000
Other Deductions	156,000,000	1,300,000		157,300,000
Total Expenses	277,900,000	1,324,000	28,500	279,252,500
Federal Taxable Income	-4,200,000	29,676,000	29,648,500	55,124,500
Federal Dividend Deduction	0	-29,676,000	0	-29,676,000
Federal Line 30	-4,200,000	0	29,648,500	25,448,500

Per IL-1120	IL-1120 2009 Domestic Parent	IL-1120 REIT Chicago	IL-1120 Unitary Group FTI	REIT Holding Co Bahamas
Federal Taxable Income	-4,200,000	0	-4,200,000	29,647,500
				Excluded Under 80/20

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The above example shows how the loophole works. In this case the parent is the UB filer that has two subsidiaries – REIT Chicago and REIT Holding Co. Bahamas (REIT Bahamas). REIT Chicago has offices and employees in Chicago and REIT Bahamas is a holding company that has no employees, but is listed on the consolidated federal return because it is incorporated in Delaware. The taxpayer is a three-factor company; so the 80/20 test is based on property and payroll. The taxpayer contracts with a third party in the Bahamas to operate its Bahamas subsidiary and claims that all property and payroll is in the Bahamas.

REITs cannot be included in a federal consolidated group. However, this arrangement has no federal income tax effect, because IRC § 857(c) provides that no dividends-received deduction is allowed to corporations for REIT dividends, and IRC Section 861 provides that dividends from US corporations are US-sourced, making them taxable even to non-US taxpayers. Accordingly, REIT Holding Co. Bahamas is fully taxable on the dividends that REIT Chicago pays to it.

However, for Illinois income tax purposes, on the IL-1120 Schedule UB, REIT Chicago still gets the federal dividends-paid deduction, but the corresponding dividend income received by REIT Holding Co. Bahamas is excluded from the group's base income and the dividend income is not sourced to Illinois. As a result, federal taxable income for all of the parties is 25,448,500, but the Illinois unitary business group shows a federal loss of -4,200,000.

The addition modification reverses the federal dividend subtraction of $29,676,000 and gives REIT-Bahamas a subtraction modification of $29,676,000 (if it were an Illinois filer) as follows:

Per IL-1120	2009 Domestic Parent	REIT Chicago	Unitary Group FTI	REIT Holding Co Bahamas
Federal Taxable Income	-4,200,000	0	-4,200,000	29,648,500
REIT Addition Mod.		29,676,000	29,676,000	
REIT Subtraction Mod.				-29,676,000
Base Income after PA 95-0233	-4,200,000	29,676,000	25,476,000	-27,500
				Excluded Under 80/20

Under the addition and subtraction modifications REIT Bahamas is still an 80/20 company; however, the income and expenses have now been properly matched to each company. Assuming there are no other addition or subtraction modifications, base income on the Schedule UB will be $25,476,000 thereby eliminating the tax loophole.

The same facts above except that REIT Bahamas is included in the unitary group. In that case there is no tax loophole since the federal taxable income of all of the members is

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included in the group's base income. The addition and subtraction modifications still apply, but they result in zero tax effect as follows:

2009 Per IL-1120	2009 Domestic Parent	REIT Chicago	REIT Holding Co Bahamas	Unitary Group FTI
Federal Taxable Income	-4,200,000	0	29,648,500	25,448,500
New REIT Addition Mod.		29,676,000		29,676,000
New REIT Subtraction Mod.			-29,676,000	-29,676,000
Base Income	-4,200,000	29,676,000	-27,500	25,448,500

L. IITA § 218 College Prepaid Tuition Credit Addition

(IITA § 203(b)(2)(E-16))

This modification applies to taxpayers who, for tax years ending on or after December 31, 2009 and on or before December 30, 2020 claim a credit for making a matching contribution to a specified college savings plan.

The credit is calculated on Schedule 1299-D and reported in Step 7 on the Form IL-1120. The addition modification is reported on Schedule M and included in Step 2 on the Other Additions line on the Form IL-1120. IAC § 100.2193(f) instructs the taxpayer to keep sufficient documentation regarding the contribution. Auditors should refer to this documentation to verify the modification.

For more information on Income Tax credits, refer to Chapter 36 of the Audit Manual.

M. Domestic Production Activities Deduction

(IITA § 203(b)(2)(E-17))

This modification applies to taxpayers who, for tax years ending on or after December 31, 2017, claim the deduction allowed under IRC § 199 for businesses that perform domestic manufacturing and certain other production activities. This addition is required for corporations, partnerships, individuals, trusts, and estates. The domestic production activities deduction is reported on federal Form 1120, Line 25 (2016 form). Taxpayers are required to calculate the deduction on federal Form 8903. For Illinois, the modification is reported on Schedule M – Other Additions and Subtractions, Line 9 (2017 form). Auditors should review the applicable forms to ensure the correct amount is added back on the Illinois return.

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N. Business Expense Recapture

(IITA § 203(e)(3))

For tax years ending on or after July 30, 2004, if the taxpayer claims any item of income (If a corporate return, lines 1 through 10 of page 1 of the US 1120) as nonbusiness income, and if in earlier years the taxpayer reported the same item as business income, then all related business expenses, without limitation, for the current year and the two preceding taxable years must be recaptured in the current year. Schedule NB was revised in 2004 to calculate this recapture. The recapture is explained in IAC § 100.2405(d).

Business expenses that are recaptured must relate to the item of nonbusiness income and must have been expenses deducted from federal taxable income that flowed through to the Illinois return. It does not matter if the business expenses are not in Illinois. If the recapture relates to the gain or loss on the sale of the stock of a unitary subsidiary, then the business expenses will be all of the expenses of that subsidiary that are listed on the Schedule UB. These expenses can include:

- Salaries and wages
- Employee benefits
- Repairs & maintenance
- Bad debts
- Rent expense
- Interest expense
- Depreciation & depletion expenses
- Advertising
- Other deductions not included in cost of goods sold*

*Note: Cost of goods sold, including purchases of inventory, is not an expense and so is not subject to recapture under IITA § 203(e)(3).

If the nonbusiness income relates to a sale of stock in a company that is not unitary, or if the nonbusiness income relates to interest, dividends or royalties, then it will be challenging for the auditor to determine what business expenses relate to the holding of that asset. Business expenses on those items may include:

- Salaries and benefits of company employees who monitor the asset
- Outside attorney, brokerage fees, and bank fees
- Interest expenses, if any, in the holding of investments
- Research and development costs in the case of royalty income

The recaptured expenses are reported as an addition modification to the current year's return along with a corresponding increase to nonbusiness income reported on the

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Schedule NB. The recaptured expenses are then reported as an adjustment to Illinois nonbusiness income based on the total recaptured expenses times the Illinois apportionment factor that is either three-year average factor or the current year's apportionment factor, whichever is greater. The modification is calculated on IL Schedule NB, Line 11 and reported on IL Schedule M, Line 4. Refer to Chapter 26 for discussion on nonbusiness income and related expenses.

Example:

The audit period covers calendar years 2013 and 2014. ABC and XYZ have been filing unitary since at least 2002. XYZ is located in California and never had nexus in Illinois. In December of 2014 ABC sells XYZ and recognizes a gain of $2 million that is reported on ABC's 2014 IL-1120 as nonbusiness income allocable to the State of California. The auditor determines that the gain is nonbusiness income and that there is $200,000 in nonbusiness expenses for attorney and accounting fees incurred by ABC in its sale of XYZ.

Note: If this scenario was real, we would probably treat the gain as business income, and the recapture of business expenses would be mentioned in the auditor's comments as an alternative tax computation that must be made if it is determined that the gain is nonbusiness. It is shown here as nonbusiness income only for illustrative purposes.

The US 1120 and IL-1120s show the following amounts for 2012, 2013 and 2014:

	2012	**2012**	**2012**
	PER US 1120 RETURN		
	ABC	XYZ	Total
Gross income	1,000,000	400,000	1,400,000
Interest Income	100,000		100,000
Total Income	1,100,000	400,000	1,500,000
EXPENSES			
Wages	500,000	85,000	585,000
Interest Expense	100,000	100,000	200,000
Depreciation	150,000	100,000	250,000
Other Expenses	400,000	150,000	550,000
Total Expenses	1,150,000	**435,000**	1,585,000
Taxable Income	-50,000	-35,000	-85,000

2012

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	PER IL 1120 AS FILED
Line 1 federal taxable income on IL-1120	-85,000
Municipal Interest addition modification	75,000
Total Base Income	-10,000
Base income subject to apportionment	-10,000
(No nonbusiness income claimed)	
Illinois apportionment factor	42.00%
Illinois net loss	-4,200
(Carry to 2013)	

	2013	**2013**	**2013**
	PER US 1120 RETURN		
	ABC	XYZ	Total
Gross income	3,000,000	750,000	3,750,000
Interest Income	100,000		100,000
Total Income	3,100,000	750,000	3,850,000
EXPENSES			
Wages	500,000	200,000	700,000
Interest Expense	100,000	100,000	200,000
Depreciation	100,000	100,000	200,000
Other Expenses	300,000	200,000	500,000
Total Expenses	1,000,000	**600,000**	1,600,000
Taxable Income	2,100,000	150,000	2,250,000

	2013 PER IL 1120 AS FILED
Line 1 federal taxable income on IL-1120	2,250,000
Municipal Interest addition modification	100,000
Total Base Income	2,350,000
Base income subject to apportionment	2,350,000
(No nonbusiness income claimed)	
Illinois apportionment factor	50.00%
Illinois net income	1,175,000
Illinois net operating loss carryover from 2012	4,200
Illinois net income after INL	1,170,800

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Total Income tax due at 7.3% $85,468

	2014	2014	2014	2014
	PER US 1120 RETURN			As
	ABC	XYZ	Total	Audited
Gross income	2,000,000	500,000	2,500,000	2,500,000
Interest Income	100,000		100,000	100,000
Capital gain - sale of	0	0	0	0
XYZ on 12/31/2004	2,000,000		2,000,000	2,000,000
Total Income	4,100,000	500,000	4,600,000	4,600,000
EXPENSES				
Wages	500,000	100,000	600,000	600,000
Interest Expense	100,000	100,000	200,000	200,000
Depreciation	100,000	100,000	200,000	200,000
Nonbusiness Selling				
Expenses on sale of XYZ	**200,000**		**200,000**	200,000
Other Expenses	300,000	100,000	400,000	400,000
Total Expenses	1,200,000	**400,000**	1,600,000	1,600,000
Taxable Income	2,900,000	100,000	3,000,000	3,000,000

	2014	2014
Audit adjustments	PER IL 1120	PER AUDIT
Line 1 federal taxable income on IL-1120	3,000,000	3,000,000
Municipal Interest addition modification	100,000	100,000
Add back XYZ's expenses for 2012	0	**435,000**
Add back XYZ's expenses for 2013	0	**600,000**
Add back XYZ's expenses for 2014		**400,000**
(Show as an-other addition modification)		
Total Base Income	3,100,000	4,535,000
Nonbusiness Income Reported	2,000,000	2,000,000
Recapture of XZY's Business Expenses	0	**1,435,000**
(Show as increase to nonbusiness income)		
Deduct out nonbusiness expenses incurred by ABC	**-200,000**	**-200,000**
Total nonbusiness income everywhere per audit	1,800,000	3,235,000
Base income subject to apportionment	1,300,000	1,300,000
Illinois apportionment factor	58.00%	58.00%
Illinois net income	754,000	754,000
Nonbusiness income allocable to Illinois		
Recapture of $1,435,000 x 58% factor		
(Show as nonbusiness income allocable to ILL)		**832,300**
Total Illinois income	754,000	1,586,300
Total Income tax due at 7.3%	$55,052	$157,999

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Note 1	
Apportionment factor for 2012	42%
Apportionment factor for 2013	50%
Apportionment factor for 2014	58%
Sub Total	150%
Average factor, divide by 3	50%

The factor used is the greater of the current year's factor, or the three-year average. The current year's factor of 58% is used since it is greater than the three-year average.

Note that Illinois business income is the same with or without the recapture.
Also, the Illinois net operating loss in one of the years has no effect on the recapture computation.

There are three audit adjustments for 2014:

1. Increase other addition modifications by $1,435,000.

IITA § 203(e)(3) requires recapture of **all** of the business expenses incurred by XYZ over the current year and two most recent prior years. A short-period return counts as one year. Therefore on the EDA-25 the auditor adds back, as an addition modification, all of XYZ's business expenses for 2012, 2013 and 2014, which are $435,000, $600,000, and $400,000 respectively.

The EDA-27 will state the following adjustment: "We recaptured business expenses related to your nonbusiness income. Ref: IITA § 203(e)(3)".

2. Increase nonbusiness income everywhere for $1,435,000.

The same $1,435,000 in business expenses above is then shown as an <u>increase</u> to nonbusiness income everywhere per audit. This is the way it is shown on the Schedule NB. The adjustment is necessary so that the Illinois portion of these business expenses can be allocated to Illinois in the adjustment below.

The EDA-27 will state the following adjustment: "We adjusted your nonbusiness income by the amount of recaptured business expenses. Ref: IITA § 203(e)(3)".

3. Increase nonbusiness income allocable to Illinois for $832,300.

The auditor has to calculate the Illinois portion of the recaptured business expenses based on the Illinois apportionment factor for the entire unitary group. Under IITA § 203(e)(3) the Illinois factor is the greater of the three-year average factor or the current year's apportionment factor. In the example above the current Illinois factor of 58% is

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greater than the three-year average of 50%. Therefore the portion of business expenses allocable to Illinois is $832,300 ($1,435,000 x 58%).

The EDA-27 will state the following adjustment: "We recaptured Illinois business expenses related to your nonbusiness income. Ref: IITA § 203(e)(3)."

Summary:

In the above example since XYZ is included in the unitary group, all of its expenses are subject to recapture since they are federal business expenses on the Illinois Schedule UB.

If the auditor concludes that XYZ should not have been included in the unitary group and makes an audit adjustment to exclude the company from the group for all years within statute, then the audit report will reflect only the first adjustment above for the $200,000 in nonbusiness expenses. There would be no recapture of XYZ's business expenses since they were not used to reduce federal taxable income reported on the IL-1120, Schedule UB. The recapture provision is only for business expenses that were used to reduce federal taxable income.

If the auditor concludes that the gain is business income, then there will be no recapture of business expenses. However, if the taxpayer disagrees with Audit's determination that the gain is business income, then the auditor's workpapers detailing the recapture must be attached to the auditor's letter of comments for future reference.

VIII. EXHIBITS

A. Form Line References

The following pages contain examples of the 2012 IL-1120 and Schedule M, referencing line specific information on the addition modifications.

- Exhibit one, page 43 – 2012 IL-1120, IITA cite references
- Exhibit two, page 44 – 2012 IL Schedule M, IITA cite references
- Exhibit three, page 45 – 2012 IL-1120, line verification information
- Exhibit four, page 46 – 2012 IL Schedule M, line verification information

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Step 2: Figure your income or loss

1	Federal taxable income from U.S. Form 1120, Line 30. **Attach** a copy of your federal return.	1	203(e)(1)	.00
2	Net operating loss deduction from U.S. Form 1120, Line 29a. This amount cannot be negative.	2	203(b)(2)(D)	.00
3	State, municipal, and other interest income excluded from Line 1.	3	203(b)(2)(A)	.00
4	Illinois income and replacement tax deducted in arriving at Line 1.	4	203(b)(2)(B)	.00
5	Illinois Special Depreciation addition. **Attach** Form IL-4562.	5	203(b)(2)(E-10) & (E-11)	
6	Related-party expenses additions. **Attach** Schedule 80/20.	6	203(b)(2)(E-12)(E-13) & (E-14)	
7	Distributive share of additions. **Attach** Schedule(s) K-1-P or K-1-T.	7		.00
8	Other additions. **Attach** Schedule M (for businesses).	8	See Schedule M	.00
9	Add Lines 1 through 8. This amount is your income or loss.	9		.00

Step 3: Figure your base income or loss

10	Interest income from U.S. Treasury and other exempt federal obligations.	10	.00		
11	Enterprise Zone or River Edge Redevelopment Zone Dividend subtraction. **Attach** Schedule 1299-B.	11	.00		
12	Enterprise Zone or River Edge Redevelopment Zone Interest subtraction. **Attach** Schedule 1299-B.	12	.00		
13	High Impact Business Dividend subtraction. **Attach** Schedule 1299-B.	13	.00		
14	High Impact Business Interest subtraction. **Attach** Schedule 1299-B.	14	.00		
15	Contribution subtraction. **Attach** Schedule 1299-B.	15	.00		
16	Contributions to certain job training projects. See instructions.	16	.00		
17	Foreign Dividend subtraction. **Attach** Schedule J. See instructions.	17	.00		
18	Illinois Special Depreciation subtraction. **Attach** Form IL-4562.	18	.00		
19	Related-party expenses subtraction. **Attach** Schedule 80/20.	19	.00		
20	Distributive share of subtractions. **Attach** Schedule(s) K-1-P or K-1-T.	20	.00		
21	Other subtractions. **Attach** Schedule M (for businesses).	21	.00		
22	Total subtractions. Add Lines 10 through 21.			22	.00
23	**Base income or loss.** Subtract Line 22 from Line 9.			23	.00

STOP

A If the amount on Line 23 is derived inside Illinois only, check this box and write the amount from Step 3, Line 23 on Step 5, Line 35. You may not complete Step 4. (You must leave Step 4, Lines 24 through 34 blank.) ☐

B If any portion of the amount on Line 23 is derived outside Illinois, check this box and complete all lines of Step 4. See instructions. ☐

Step 4: Figure your income allocable to Illinois (Complete only if you checked the box on Line B, above.)

24	Nonbusiness income or loss. **Attach** Schedule NB.	24	.00		
25	Trust, estate, and non-unitary partnership business income or loss included in Line 23.	25	.00		
26	Add Lines 24 and 25.			26	.00
27	Business income or loss. Subtract Line 26 from Line 23.			27	.00
28	Total sales everywhere. This amount cannot be negative.	28			
29	Total sales inside Illinois. This amount cannot be negative.	29			
30	Apportionment Factor. Divide Line 29 by Line 28 (carry to six decimal places).	30	.		
31	Business income or loss apportionable to Illinois. Multiply Line 27 by Line 30.			31	.00
32	Nonbusiness income or loss allocable to Illinois. **Attach** Schedule NB.			32	.00
33	Trust, estate, and non-unitary partnership business income or loss apportionable to Illinois.			33	.00
34	**Base income or loss allocable to Illinois.** Add Lines 31 through 33.			34	.00

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Illinois Department of Revenue

2012 Schedule M

Attach to your Form IL-1120, IL-1120-ST, IL-1065, or IL-1041

Other Additions and Subtractions (for businesses)

Year ending

Month Year

IL Attachment No. 15

Step 1: Provide the following information

Write your name as shown on your tax return.

Write your Federal Employer Identification no. (FEIN)

Step 2: Figure your additions

Write the amount of

1	Capital gain taxed under IRC Section 852(b)(3).	1	203(b)(2)(C)	.00
2	Notes, bonds, debentures, or obligations issued by the Governments of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands.	2	203(b)(2)(A)	.00
3	Lloyd's plan of operation loss if reported on your behalf on Form IL-1023-C and included in your federal taxable income.	3		.00
4	Business expense recapture.	4	203(e)(3)	.00
5	Any other state's income tax deducted from federal taxable income **(Form IL-1041 filers only)**.	5		.00
6	Capital loss to be carried forward **(Form IL-1041 filers only)**.	6		.00
7	Credit taken on Schedule 1299-A or 1299-D for college savings plan contributions you made as an employer.	7	203(b)(2)(E-16)	.00
8	Dividends paid by a captive REIT.	8	203(b)(2)(E-15)	.00
9	Other additions - Identify each item. _____	9	203(b)(2)(A)(E)(E-5)	
10	**Total additions.** Add Lines 1 through 9. Write the amount here and on your Form IL-1120, Line 8, Form IL-1120-ST, Line 21, Form IL-1065, Line 22 or Form IL-1041, Line 10. →	10		.00

Step 3: Figure your subtractions

Write the amount of

11	Exempt interest dividends paid by regulated investment companies (IRC § 852(b)(5)).	11	.00
12	Notes, bonds, debentures, or obligations issued by the Governments of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands to the extent the amounts were required to be added back on Line 2.	12	.00
13	Lloyd's plan of operation income if reported on your behalf on Form IL-1023-C.	13	.00
14	Income for which you claimed a credit under IRC § 1341.	14	.00
15	Expense deductions disallowed federally under IRC §§ 171(a)(2), 265, 280C, 291(a)(3), or 832(b)(5)(B)(i). Specify any amount relating to the following:		
	a Interest expenses relating to municipal income (IRC § 291)	a	.00
	b Interest and other expenses related to federally tax-exempt interest (IRC § 265)	b	.00
	c Bond premium amortization on federally tax-exempt bonds (IRC § 171)	c	.00
	d Expenses related to certain federal credits (IRC §280C)	d	.00
	e Reduction in insurance company reserves (IRC §832)	e	.00
	f Reduction in depreciation related to railroad maintenance credits (IRC § 45G)	f	.00
	g Gross income resulting from alternative energy credits (IRC § 87)	g	.00
16	Add Lines 15a through 15g.	16	.00
17	Add Lines 11 through 14 and Line 16. Write the amount here and on Line 18.	17	.00

Schedule M (R-12/12) Page 1 of 4

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Step 2: Figure your income or loss

1	Federal taxable income from U.S. Form 1120, Line 30. **Attach** a copy of your federal return.	1	US 1120 Line 30 .00
2	Net operating loss deduction from U.S. Form 1120, Line 29a. This amount cannot be negative.	2	US 1120 Line 29a .00
3	State, municipal, and other interest income excluded from Line 1.	3	US 1120 Sch K, L 9 or Sch M-1 L 7
4	Illinois income and replacement tax deducted in arriving at Line 1.	4	US 1120 Line 17 .00
5	Illinois Special Depreciation addition. **Attach** Form IL-4562.	5	US 4562 .00
6	Related-party expenses additions. **Attach** Schedule 80/20.	6	IL Sch 80/20 .00
7	Distributive share of additions. **Attach** Schedule(s) K-1-P or K-1-T.	7	US Sch K-1 .00
8	Other additions. **Attach** Schedule M (for businesses).	8	IL Sch M .00
9	Add Lines 1 through 8. This amount is your income or loss.	9	.00

Step 3: Figure your base income or loss

10	Interest income from U.S. Treasury and other exempt federal obligations.	10	.00		
11	Enterprise Zone or River Edge Redevelopment Zone Dividend subtraction. **Attach** Schedule 1299-B.	11	.00		
12	Enterprise Zone or River Edge Redevelopment Zone Interest subtraction. **Attach** Schedule 1299-B.	12	.00		
13	High Impact Business Dividend subtraction. **Attach** Schedule 1299-B.	13	.00		
14	High Impact Business Interest subtraction. **Attach** Schedule 1299-B.	14	.00		
15	Contribution subtraction. **Attach** Schedule 1299-B.	15	.00		
16	Contributions to certain job training projects. See instructions.	16	.00		
17	Foreign Dividend subtraction. **Attach** Schedule J. See instructions.	17	.00		
18	Illinois Special Depreciation subtraction. **Attach** Form IL-4562.	18	.00		
19	Related-party expenses subtraction. **Attach** Schedule 80/20.	19	.00		
20	Distributive share of subtractions. **Attach** Schedule(s) K-1-P or K-1-T.	20	.00		
21	Other subtractions. **Attach** Schedule M (for businesses).	21	.00		
22	Total subtractions. Add Lines 10 through 21.			22	.00
23	**Base income or loss.** Subtract Line 22 from Line 9.			23	.00

STOP

A If the amount on Line 23 is derived inside Illinois only, check this box and write the amount from Step 3, Line 23 on Step 5, Line 35. You may not complete Step 4. (You must leave Step 4, Lines 24 through 34 blank.) ☐

B If any portion of the amount on Line 23 is derived outside Illinois, check this box and complete all lines of Step 4. See instructions. ☐

Step 4: Figure your income allocable to Illinois (Complete only if you checked the box on Line B, above.)

24	Nonbusiness income or loss. **Attach** Schedule NB.	24	.00		
25	Trust, estate, and non-unitary partnership business income or loss included in Line 23.	25	.00		
26	Add Lines 24 and 25.			26	.00
27	Business income or loss. Subtract Line 26 from Line 23.			27	.00
28	Total sales everywhere. This amount cannot be negative.	28			
29	Total sales inside Illinois. This amount cannot be negative.	29			
30	Apportionment Factor. Divide Line 29 by Line 28 (carry to six decimal places).	30	.		
31	Business income or loss apportionable to Illinois. Multiply Line 27 by Line 30.			31	.00
32	Nonbusiness income or loss allocable to Illinois. **Attach** Schedule NB.			32	.00
33	Trust, estate, and non-unitary partnership business income or loss apportionable to Illinois.			33	.00
34	**Base income or loss allocable to Illinois.** Add Lines 31 through 33.			34	.00

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Illinois Department of Revenue

2012 Schedule M

Attach to your Form IL-1120, IL-1120-ST, IL-1065, or IL-1041

Other Additions and Subtractions (for businesses)

Year ending

Month Year

IL Attachment No. 15

Step 1: Provide the following information

Write your name as shown on your tax return.

Write your Federal Employer Identification no. (FEIN)

Step 2: Figure your additions

Write the amount of

1	Capital gain taxed under IRC Section 852(b)(3).	1	US1120 Sch D, L17
2	Notes, bonds, debentures, or obligations issued by the Governments of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands.	2	Copies of .00
3	Lloyd's plan of operation loss if reported on your behalf on Form IL-1023-C and included in your federal taxable income.	3	.00
4	Business expense recapture.	4	IL Sch NB .00
5	Any other state's income tax deducted from federal taxable income **(Form IL-1041 filers only)**.	5	.00
6	Capital loss to be carried forward **(Form IL-1041 filers only)**.	6	.00
7	Credit taken on Schedule 1299-A or 1299-D for college savings plan contributions you made as an employer.	7	Documentation of
8	Dividends paid by a captive REIT.	8	US1120 REIT .00
9	Other additions - Identify each item.	9	Documentation of
10	**Total additions.** Add Lines 1 through 9. Write the amount here and on your Form IL-1120, Line 8, Form IL-1120-ST, Line 21, Form IL-1065, Line 22 or Form IL-1041, Line 10. →	10	.00

Step 3: Figure your subtractions

Write the amount of

11	Exempt interest dividends paid by regulated investment companies (IRC § 852(b)(5)).	11	.00
12	Notes, bonds, debentures, or obligations issued by the Governments of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands to the extent the amounts were required to be added back on Line 2.	12	.00
13	Lloyd's plan of operation income if reported on your behalf on Form IL-1023-C.	13	.00
14	Income for which you claimed a credit under IRC § 1341.	14	.00
15	Expense deductions disallowed federally under IRC §§ 171(a)(2), 265, 280C, 291(a)(3), or 832(b)(5)(B)(i). Specify any amount relating to the following:		
a	Interest expenses relating to municipal income (IRC § 291)	a	.00
b	Interest and other expenses related to federally tax-exempt interest (IRC § 265)	b	.00
c	Bond premium amortization on federally tax-exempt bonds (IRC § 171)	c	.00
d	Expenses related to certain federal credits (IRC §280C)	d	.00
e	Reduction in insurance company reserves (IRC §832)	e	.00
f	Reduction in depreciation related to railroad maintenance credits (IRC § 45G)	f	.00
g	Gross income resulting from alternative energy credits (IRC § 87)	g	.00
16	Add Lines 15a through 15g.	16	.00
17	Add Lines 11 through 14 and Line 16. Write the amount here and on Line 18.	17	.00

Schedule M (R-12/12) Page 1 of 4

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B. Economic Substance Doctrine Examples

The following examples, although occurring prior to the codification of the economic substance doctrine, outline instances where the doctrine would likely apply in regard to denying safe harbor and making adjustments to certain modifications.

1. Royalty Expense

- No. 4762 (Ore. T.C. July 1, 2008)

PACIFICARE HEALTH SYSTEMS Inc. (PCHS) is the parent of an affiliated group of health maintenance organizations. PCHS filed a consolidated federal return. For Oregon tax purposes, PCHS and its non-insurance subsidiaries filed a combined return, while the insurance subsidiary filed a separate return.

PCHS contributed the trademarks and other intellectual property used by the affiliated group to the insurance subsidiary on Oct. 1, 1998, and the insurance subsidiary began collecting royalties.

The Oregon Department of Revenue (Department) disallowed the royalty expense deductions claimed by the PCHS group in 1999 and 2000. The Department did not dispute the arm's-length nature of the royalty payments. Instead, the Department argued that the initial transfer of intellectual property should be disregarded for tax purposes. In other words, PCHS remained the owner of the intellectual property for tax purposes.

The Oregon Tax Court concluded that "the proper analysis is to consider which corporation was, for tax purposes, the owner of the Intellectual Properties." On that question, federal tax law governs.

- The first step is to address "whether in substance, as well as form, there had in fact been a transfer of the intellectual property." *Eli Lilly & Co. v. Comm'r*, 856 F.2d 855, 860 (7th Cir. 1988); *GD Searle & Co. v. Comm'r*, 88 T.C. 252, 341 (1987).
- The leading case on when ownership changes for tax purposes is *Comm'r v. Sunnen*, 333 U.S. 591 (1948).
- Control of assets is a primary determinant of tax ownership, according to *National Lead Co. v. Comm'r*, 336 F.2d 134 (2d Cir. 1964).

The tax court reasoned their decision as follows:

> A careful review of the legal and practical relationships among the members of taxpayer's corporate family leads the court to the conclusion that the purported transfer of the Intellectual Properties to the Insurance Subsidiary should not be respected for income tax purposes.

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> First, and most important, if not decisive, the purported transfer was one that could be rescinded at any time at the option of taxpayer. Notably, the Insurance Subsidiary bound itself, in the license agreements, to make no assignment of the license agreements other than to a commonly controlled or controlling entity without the consent of the licensee corporation.

The license agreements also provided PCHS with the right to demand re-conveyance. The tax court continued:

> Under the governing case law, courts have found no tax transfer to have occurred where either control of property or the economic benefits of the property have been retained. The question is whether the purported transfer results in any substantial change in the economic position of the purported transferor.

Various credit arrangements resulted in a circular flow of cash, which evidenced a lack of change in PCHS's economic position.

2. Both Interest And Royalty Expenses

- Nos. C282754, C295077, C299008 (Mass. App. Tax Bd. Jan. 31, 2011), affirmed, No. 2011-P-0632 (Mass. App. Ct.)

Kimberly-Clark Corp. (K-C) had a centralized cash management system. All affiliate cash receipts were deposited into a lockbox on a daily basis and swept up to K-C. Various subsidiary expenses were paid out of the common pool, and the excess cash net of expenses was recorded as a payable on the general ledger. Interest was calculated on the last day of each month. None of the cash was ever returned to the subsidiaries.

In its audit of tax years 2001-2003, the Massachusetts Commissioner of Revenue denied a deduction for interest expense associated with the cash management system. For a transaction to give rise to a valid interest deduction, it must constitute true indebtedness. Based on the fact that the advances remained with K-C indefinitely, coupled with the failure of the affiliates to request repayment, the Board concluded that the parties never intended to repay the cash advances.

K-C also transferred its patents to Kimberly-Clark Worldwide Inc. (K-C W Inc.) and appointed K-C W Inc. as the exclusive agent with respect to its trademarks. K-C paid K-C W Inc. a royalty for the patent license and trademark sublicense. Employees involved in manufacturing, R&D and patent protection were also transferred to K-C W Inc. The only personnel with significant involvement in the reorganization were those responsible for tax matters.

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The record did not indicate that any licensing agreements were entered into with third parties. Royalty payments were returned to K-C by virtue of its cash management system. The Commissioner disallowed the deduction for royalties paid to K-C W Inc.

- The sham transaction doctrine "gives the commissioner the authority 'to disregard, for taxing purposes, transactions that have no economic substance or business purpose other than tax avoidance.'" (quoting *The Sherwin-Williams Co. v. Comm'r of Revenue*, 438 Mass. 71, 79 (2002)) This doctrine "prevents taxpayers from claiming the tax benefits of transactions that, although within the language of the tax code, are not the type of transaction the law intended to favor with the benefit." (quoting *Syms Corp. v. Comm'r of Revenue*, 436 Mass. 505, 510 (2002))

- Massachusetts had adopted an add-back statute with an exception for transactions that have a valid business purpose and economic substance.

Noting that the royalties were immediately returned to K-C, the Massachusetts Appellate Tax Board concluded that "[s]uch a circular flow of funds among related entities does not indicate a substantive economic transaction for tax purposes." The Board distinguished *Sherwin-Williams*, where the court emphasized the absence of a circular flow of funds and the subsidiaries' ability to invest the royalties. Also, the subsidiaries in *Sherwin-Williams* entered into licensing contracts with third parties.

- "[A] transfer and license-back transaction between a parent and its wholly-owned subsidiary which results in a *de facto* exclusive license arrangement is not an arm's-length transaction." (quoting *The TJX Cos. Inc. v. Comm'r*, Mass. ATB Findings of Fact and Reports 2007-790, 854)

3. <u>Tax Avoidance Restructuring</u>

- No. 07-I-17, Wis. Tax Appeals Comm'n (March 29, 2010), appeal dismissed, No. 2010CV002271 (Dane County Cir. Ct.)

In 1998, the treasurer of Hormel Foods Corp. made a presentation to the board of directors recommending a restructuring. Intellectual property (IP) would be transferred to a subsidiary and licensed back. State tax savings were estimated at $1.6 million annually. The treasurer did not discuss business savings or increased profits resulting from the restructuring.

On July 27, 1998, the board of directors approved the transfer of Hormel Foods patents, trademarks and copyrights to Foods LLC; the transfer of the equipment and personnel involved in R&D to Foods LLC; and the license of the intellectual property (IP) to Hormel Foods. The board of directors identified 6 objectives related to better management of the IP.

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Ernst & Young performed a study to determine arm's-length rates for royalties. Under an administrative services agreement, Hormel Foods continued to provide all accounting, payroll, data administration, risk management, legal and financial reporting and other services.

The Wisconsin DOR audited Hormel Foods for tax years 1996 through 1999. The Department made adjustments for the royalties paid by Hormel Foods to Foods LLC and intercompany interest expense. The Wisconsin Tax Appeals Commission analyzed the transactions for economic substance, business purpose, and a showing that the transaction was not shaped solely for tax avoidance. Hormel Foods argued that the business purpose for forming Foods LLC was to protect and promote the IP.

The Commission concluded that the primary purpose for creating Foods LLC was tax avoidance. The idea to restructure originated with Ernst & Young and Hormel Foods's tax director as a plan to reduce state income taxes. The new structure created a circular flow of funds. Hormel Foods's other alleged purposes were a mere fig leaf covering the real purpose. Hormel Foods's licenses were exclusive, and no IP was licensed to third parties.

Hormel Foods failed to prove the royalty deductions were ordinary and necessary expenses.

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IX. HISTORICAL EXTRACTS

A. Line 1 Less Than Zero

For many years, the Department had taken the position that Line 1 of the Illinois return could not be less than zero even if the federal return showed a NOL. As a result of Public Act 83-951 and the Illinois court decision in the case of Chicago Title the Department has changed that position. Refer to Chapter 49 for a synopsis of this case and the complete case citation.

For tax years ending on or before November 30, 1983, the Chicago Title court decision governs. That case overruled the Department's interpretation that federal taxable income entered on Line 1 of the Illinois return could not be less than zero. The decision was not limited to loss years; however, it did state that the loss could not be used twice.

For tax years ending on or after December 1, 1983 (the effective date of Public Act 83-951) and ending prior to December 31, 1986, the amount of taxable income to be entered on Line 1 for Illinois purposes could be an amount less than zero in a loss year only.

B. Bonus Depreciation

Taxpayers have claimed that they received no tax benefit from the federal bonus depreciation in the current period and therefore should not be required to add-back the bonus depreciation.

The fact that they would have had the same taxable income had they elected not to take bonus depreciation does not mean they did not actually take the deduction, nor does it mean they derived no benefit from it. The bonus depreciation helped offset current gross income and helped produce a loss that can be taken in future years. In any event, the IITA contains no exception for cases when taxpayers do not derive any benefit from taking bonus depreciation.

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ILLINOIS BASE INCOME OR LOSS (SUB MODS)

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I. PURPOSE

To assist auditors in determining Illinois taxable income or base income; Illinois base income is defined in IITA § 203 as equal to the taxpayer's adjusted gross income (taxable income for corporations) modified by those amounts specified within the Act. For corporations the numerous subtraction modifications begin at IITA § 203(b)(2)(F). These modifications are elaborated upon within this chapter of the Income Tax Audit Manual.

II. REFERENCE SOURCES

A. ILLINOIS INCOME TAX ACT

IITA § 203(b)(2)(F)-(Z)
IITA § 250

B. ILLINOIS REGULATIONS

86 IAC § 100.2430
86 IAC § 100.2450
86 IAC § 100.2455
86 IAC § 100.2470
86 IAC § 100.2490
86 IAC § 100.2655

C. DEPARTMENT FORMS AND PUBLICATIONS

Form IL-1120
Form IL-4562
IL Schedule J
IL Schedule M
IL Schedule 1299-B
Publication 101
FY Bulletin 1990-40

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III. GENERAL INFORMATION

A. PARTNERSHIPS, S-CORPS, TRUSTS AND ESTATES

Chapter 28 of the Audit Manual covers partnerships, Subchapter S corporations, trusts & estates. Refer to that Chapter regarding the rules for determining income for IL-1065 (Partnership), IL-1120-ST (S-Corp) or IL-1041 (Trusts and Estates) filers.

B. SUBTRACTION MODIFICATIONS

If the taxpayer does not claim a subtraction modification, auditors should not search for amounts the taxpayer may have omitted. If the taxpayer provides additional information to substantiate a subtraction modification that was not claimed or it is discovered that the taxpayer has not claimed a subtraction modification but was entitled to claim one, an amended return should be filed by the taxpayer to correct the error. Additional subtraction modifications can be allowed without an amended return being filed, but filing an amended return claiming the subtractions and requesting a refund may be necessary to preserve the taxpayer's right to the refund.

When dealing with a unitary group of companies it is important to remember that the modifications apply to all members of the unitary group, as determined in Chapter 22, not just the Illinois filers. Due to the nature of some of the modifications, an Illinois filer may be the only one affected by a specific modification (such as the Illinois Income Tax refund subtraction) however, in general, all unitary group members should be examined to determine if any of the Illinois modifications exist.

Subtraction modifications for items of income allowed by IITA § 203(b)(2) may be claimed on the Illinois return only to the extent of the amounts otherwise included in base income. It is important that auditors confirm the item has been included in base income, and not subtracted under some other provision before a taxpayer has subtracted an item of exempt income. IITA § 203(g) explicitly prohibits items of income to be deducted more than once.

Public Act 88-660, effective September 16, 1994, created IITA § 250. This section provides that all exemptions, credits and deductions enacted after September 16, 1994, shall be limited by a reasonable and appropriate sunset date. If a sunset date is not specified in the Public Act which creates the exemption, credit or deduction, the exemption, credit or deduction will automatically expire for tax years beginning on or after five years after the effective date of the Public Act creating the exemption, credit or deduction unless exempt from IITA § 250 or extended by other applicable law. For example, Public Act 97-0636 added subsection (b) to IITA § 250 to provide that any exemption, credit, or deduction scheduled to sunset in years 2011, 2012, or 2013 are extended an additional five years.

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These would be extended to then expire in 2016, 2017, or 2018. Several subtraction modifications within IITA § 203(b)(2) are explicitly exempt from the provision of IITA § 250 as noted within this chapter.

IV. APE SPECIFIC LAW APPLICATIONS

A. ILLINOIS INCOME TAX REFUNDS

(IITA § 203(b)(2)(F))

This modification is for the amount of any refund of tax imposed by the IITA that is included in federal taxable income. It does not include sales taxes, use taxes, federal or state excise taxes, or taxes from other states. This subtraction also applies in situations where an accrual-basis taxpayer reports a negative Illinois income tax expense because the accrued liability at the beginning of the tax year is greater than the sum of the year-end accrual plus payments. In this case, the taxpayer has accrued a refund into income, even if no refund has been paid, and is entitled to the subtraction.

It is important to verify the subtraction modification is:

- The amount of the refund that is actually included in federal taxable income for the taxable year
- Limited to Illinois income and replacement tax

The Illinois modification is reported on Schedule M Line 23 (on the 2011 and subsequent forms). See 86 IAC § 100.2450 for more information.

B. FOREIGN DIVIDEND GROSS-UP

(IITA § 203(b)(2)(G))

This modification is for any amount calculated under IRC § 78 and included in federal taxable income. Federally, a corporation has the option to deduct its shareholder's percentage of the foreign taxes paid by a foreign subsidiary from its computation of federal taxable income or to claim a foreign tax credit for those taxes. If a credit is chosen, the company must "gross-up" the related foreign dividends or Subpart F income to include the amount of the credit in taxable income.

- For tax years ending on or after January 1, 1975, the corporation has been allowed a subtraction modification for foreign dividend gross-up.
- For tax years ending prior to January 1, 1975, if a corporation elected to claim a Foreign Tax Credit for federal purposes and included a "gross-up" of the foreign

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dividends in federal taxable income, no deduction of this "gross-up" was allowed for Illinois purposes.

There is not and never has been an Illinois subtraction modification for the actual amount of foreign taxes paid or deemed paid.

Foreign dividend gross-up is reported on the federal Form 1120, Schedule C, Line 15. This amount should appear on the appropriate subtraction modification line of the IL-1120 or, for tax years ending on or after December 31, 1982, it is included on the IL-1120, Schedule J, (Line 14 on the 2006 and subsequent forms) which is used to compute the foreign dividends subtraction modification. Taxpayers are never allowed to claim a subtraction amount for the foreign dividend gross-up reported on the federal Form 1120, Schedule M-1. The Schedule M-1 is a reconciliation of book and tax income, not a computation of taxable income. The amount actually included in taxable income is shown on Schedule C of the federal Form 1120, and allowing the subtraction for any amount shown on the Schedule M-1 would either allow the same amount to be subtracted twice or allow a subtraction that is not actually included in taxable income.

When examining the foreign dividend gross-up subtraction it is important to verify:

- The amount of gross-up
- It has not been included as a subtraction modification twice (on the Other Subtraction Line and in the Schedule J computation).

Numerous errors on the IL Schedule J have been identified throughout the years. Those errors are outlined in the Appendix of this chapter.

C. EXEMPT INTEREST DIVIDENDS

FOR REGULATED INVESTMENT COMPANIES (RIC) ONLY—
(IITA § 203(b)(2)(H))

This modification is for the amount of exempt interest dividends paid to shareholders as defined in IRC § 852(b)(5). IRC § 852(b)(2)(D) allows a RIC to deduct dividends paid, but does not allow the deduction of dividends attributable to tax-exempt interest, because that interest is already excluded from taxable income. In order to prevent a RIC from paying Illinois tax on the add-back of exempt interest that it paid out as an exempt interest dividend, it is allowed to subtract the amount it paid out. IRC § 852(b)(5)(A)(i) states the dividends are, “reported by the company as an exempt-interest dividend in written statements furnished to its shareholders.” The auditor should request the statements for review of the subtraction.

D. EXPENSE DEDUCTIONS DISALLOWED FEDERALLY

(IITA § 203(b)(2)(I))

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86 IAC § 100.2455, Subtraction Modification for Federally Disallowed Deductions, is effective for tax years ending on or after August 13, 1999 and summarizes the following federal expense items as they appear on the Illinois Schedule M in Step 3, (Line 15 on the 2009 and subsequent forms). These items are listed in IITA § 203(b)(2)(I) and are explained in the sections below. Subparagraph (I) is exempt from the provisions of IITA § 250.

1. Interest Expenses Relating To Municipal Bond Interest Income

IRC § 291(a)(3) contains special rules for certain financial institution preference items. Financial institutions and their related modifications are discussed in Chapter 30.

2. Expenses Related To Federally Tax-Exempt Interest

IRC § 265 provides that no deduction shall be allowed for expenses and interest relating to tax-exempt income. These amounts of expense and interest, determined in accordance with the provisions of the IRC, are allowable subtractions for Illinois income tax purposes. For more information, refer to 86 IAC § 100.2455

3. Bond Premiums Amortization On Federally Tax-Exempt Bonds

IRC § 171(a)(2) disallows the deduction normally allowed for amortization of bond premium (which represents a return of the bondholder's investment included in the stated amount of interest payable on the bond) on federally tax-exempt bonds because the payment is already excluded from taxable income. Prior to the effective date of this modification the amortization of bond premium was not allowed as an offset to the addition modification for federally tax-exempt interest. The amount of amortizable bond premium for each year is computed using IRC § 171(b)(2) and (3).

Bond premium is the excess of the purchase price of the bond over the face value of the bond. The deductible amortization of bond premium is computed by multiplying the premium by the number of months in the taxable year of ownership by the taxpayer, and by dividing that amount by the number of months from the date of acquisition to the date of maturity. For more information, refer to 86 IAC § 100.2455.

4. Expenses Related To Federal Credits

IRC § 280C lists several expenses and wages that are not allowed as a deduction on the federal return because a federal credit was claimed instead. 86 IAC § 100.2455 lists the most popular federal credits. For a corporation the subtraction modifications that qualify are claimed on Schedule M, Step 3. The language on the Schedule M can change from

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year to year. It is important to verify that the federal deduction is disallowed under IRC § 280C and not a different federal section not referenced by the IITA.

In addition to the Hurricane Katrina relief mentioned in 86 IAC § 100.2455(d), the taxpayer may claim disallowed federal expenses relating to the following federal credits, as long as they claimed the federal credit in lieu of the federal deduction:

- Work Opportunity Credit, Form 5884
- Empowerment Zone Employment Credit, Form 8844
- Welfare-To-Work Credit, Form 8861
- Credit for Increasing Research Activities, Form 6765
- Indian Employment Credit under IRC § 45A
- Qualified Clinical Testing Expense ("orphan drug") Credit - Form 8820
- Agricultural Chemicals Security Credit – Form 8931

Federal deductions are NOT allowed as a subtraction modification under IITA § 203(b)(2)(I) regarding the following credits:

- Energy Efficient Home Credit, Form 8908
- Credit for Small Employer Pension Plan Startup Costs - Form 8881
- Credit for Enhanced Oil Recovery - IRC § 43(d)
- Credit for the portion of employer Social Security taxes paid with respect to employee cash tips, IRC § 45B, Form 8846
- Alcohol Fuel Credit - IRC § 40

If the auditor encounters a federal credit not listed above, then IRC § 280C must be reviewed to see if it qualifies. Merely being listed in IRC § 280C qualifies a credit for an allowable subtraction regardless of where in the IRC the credit is further detailed.

5. Reduction In Insurance Company Reserves

IRC § 832 applies to a non-life insurance company's share of state and municipal interest. See Chapter 31 for information regarding insurance companies and their modifications.

6. Reduction In Depreciation Related To Railroad Maintenance Credits

IRC § 45G was created for the railroad maintenance credit and defines it as an amount equal to 50% of the track maintenance expenditures paid or incurred by an eligible taxpayer during the taxable year. IRC § 45G(e)(3) describes the adjustment for the reduction in the basis of the track. Public Act 097-0507 created the subtraction modification for tax years ending on or after December 31, 2011.

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7. Gross Income Resulting From Alternative Energy Credits

IRC § 87 refers to alcohol and biodiesel fuels credits. Public Act 097-0507 created a subtraction modification for taxable years ending on or after December 31, 2008, for any amount included in gross income under this section. For the computation of taxable income, any amount included in gross income is comprised of:

a) the amount of the alcohol fuel credit determined with respect to the taxpayer for the taxable year under IRC § 40(a), and
b) the biodiesel fuels credit determined with respect to the taxpayer for the taxable year under IRC § 40A(a)

E. EXEMPTIONS BY VIRTUE OF STATUTE OR CONSTITUTION

(IITA § 203(b)(2)(J))

Taxpayers may subtract all amounts included in federal taxable income exempt from taxation by this State either due to Illinois' statutes or Constitution or to the U.S. Constitution, treaties or statutes. Any income from bonds or other obligations exempted will be net of bond premium amortization. Publication 101, Income Exempt from Tax is revised periodically and contains a complete list of the income exempt from tax. These exemptions are discussed in detail in 86 IAC § 100.2470 and briefly as follows.

1. U.S. Interest

86 IAC § 100.2470(b)

- Limited to the amount of U.S. government securities themselves and the interest paid thereon, exempt from state income taxation pursuant to 31 USC § 3124,
- Certain interest income that is exempt from federal taxation is also exempt from state taxation (such as interest on obligations of Puerto Rico, the Virgin Islands, or Guam).
  - In these cases the interest must first be added back as an Illinois addition modification to be deducted as an Illinois subtraction modification. See Chapter 24 for discussion on the addition modification.
- The capital gain from the sale of the U.S. government obligations is not exempt from Illinois taxation.
- The modification is for "interest net of bond premium amortization" (Bond premium amortization is discussed in detail in Chapter 24.)

Currently all interest income is reported on the federal Form 1120, Page 1, Line 5. It is necessary to obtain workpapers, which break down the sources of the interest income. The instructions to the federal Form 1120 state that interest income should:

- not be netted against related interest expense,
- the gross amount of interest should be reported on Line 5

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- related expenses are reported on the appropriate expense line,

This should also be verified in audit. If any adjustment is made to the amount of U.S. interest claimed, a schedule should be prepared indicating:

- the type of security,
- issue date,
- maturity date,
- rate of interest and
- amount of interest received

2. Obligations Of The United States

86 IAC § 100.2470(b)

Federal statute exempts stocks and obligations of the U.S. Government, as well as the interest on the obligation(s), from state income taxation. The regulation describes several characteristics of this type of obligation including among other things that they bear interest and have congressional authorization. Refer to 86 IAC § 100.2470(b) for more information.

Original issue discount (OID) bonds, the issue price is below the redemption price, and the holder receives part or all of the expected return in the form of price appreciation. The difference between the issue price and the redemption price is the OID, and a portion of the OID is required to be accrued and included in the income of the holder annually. A number of letter rulings have stated that accretion on discount of original issue discount bonds qualifies for the U.S. Government interest subtraction.

Market discount bonds are acquired for a price that is less than the principal amount of the bond. Market discount generally arises when the value of a debt obligation declines after issuance (typically, because of an increase in prevailing interest rates or a decline in the credit-worthiness of the borrower). Accrued market discount should be the total that's accrued up to the time of sale.

Under federal law the gain on the disposition of a tax-exempt obligation or any other market discount bond, purchased by the taxpayer after April 30, 1993 (regardless of the date the bond was issued) and acquired for a price that is less than the principal amount of the bond, generally will be treated as ordinary income (instead of capital gain) to the extent of accrued market discount.

Only the portion of the accrued market discount that relates to the OID bond qualifies for the US government subtraction, but only on qualified US Government bonds that have reached maturity.

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3. Other Income Exempted By Federal Statutes

86 IAC § 100.2470(c)

Other federal statutes provide exemption from state income taxation with respect to various specifically named types of income. Refer to the regulation for the complete list (intended to be exhaustive) of exempt income and the specific statutes to which each item relates.

4. Distributions From Money Market Trusts (Mutual Funds)

86 IAC § 100.2470(d)

Income received from any of the obligations listed in 86 IAC § 100.2470 (b) & (c) may be subtracted in the computation of base income, even if the obligations are owned indirectly by owning shares in a mutual fund. Refer to the regulation section for an in-depth analysis on determining the amount of subtraction.

If tax was paid on these state-exempt distributions, an amended return may be filed to claim a refund for any year still within the statute of limitations.

5. Interest On Obligations Of State/Local Governments

86 IAC § 100.2470(f)

Only income from state and local obligations specifically exempt by Illinois statute may be subtracted from federal taxable income. Auditors must ensure that the income from exempt bonds is first shown as an addition and then as a subtraction on the Illinois income tax return. Income from these bonds is not exempt if the bonds are owned indirectly through owning shares in a mutual fund. A complete list of these obligations is found on the Schedule M in Step 3 (Line 19 on the 2009 and subsequent forms).

6. Other Income Exempted by Illinois Statutes

86 IAC § 100.2470(g)

Illinois Pre-Need Cemetery Sales Act (815 ILCS 390/16) and Illinois Funeral or Burial Funds Act (225 ILCS 45/4a(c)) – income earned on funds held in a trust fund suspense account is excluded from tax until the final determination is made as to the payee of the account. Note that there is no provision in the IITA that requires this income to be added to any taxpayer's federal taxable income or adjusted gross income when this "final determination" is made, so the income will go untaxed by Illinois if it is subtracted under this provision.

Family Practice Residency Act (110 ILCS 935/4.01; PA 86-926 (HB 1494), eff. September 17, 1989) – income in the form of education loan repayments made for primary care physicians who agree to practice in designated areas for a specified period of time.

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Public Utilities Act (220 ILCS 5/8-508.1) – income earned by nuclear decommissioning trusts established pursuant to Section 8-508.1. There are two types of nuclear decommissioning trusts. One is exempt from federal income taxation the other is not. Income earned by either of these types of trusts is exempt from Illinois income taxation. REF: Sunshine Letter IT93-0162.

Home Ownership Made Easy Program [310 ILCS 55/5.1] – income earned on investments made pursuant to the Act

Illinois Prepaid Tuition Act [110 ILCS 979] – income from the Illinois prepaid tuition program, other than disbursements to beneficiaries which are not used in accordance with the applicable prepaid tuition contract. A similar subtraction is allowed for disbursements from the College Savings Pool under the State Treasurer Act [15 ILCS 505/16.5].

If a prepaid tuition contract qualifies under IRC § 529, earnings on contributions made to the Illinois Prepaid Tuition Trust Fund or the College Savings Pool under the contract are exempt from federal income taxation (and therefore Illinois income taxation) until distributed. The legislative intent in creating the Illinois prepaid tuition program does not guarantee that every prepaid tuition contract or the College Savings Pool will qualify under IRC § 529 and there is no guarantee that IRC § 529 will continue in effect. However, Section 55 of the Illinois Prepaid Tuition Act [110 ILCS 979/55] and Section 16.5 of the State Treasurer Act [15 ILCS 505/16.5] provide that assets of those programs and their income and operation shall be exempt from all taxation by the State and that disbursements to a beneficiary shall be similarly exempt from all taxation by the State of Illinois and any of its subdivisions, so long as they are used for educational purposes in accordance with the provisions of the program.

College Savings Programs – up to $2,000 of income derived by individuals from investments made under former Section 30-15.8(a)

7. U.S. Interest Income **Not** Exempt From Illinois Income Taxation

86 IAC § 100.2470(h)

86 IAC § 100.2470(h) lists specific interest bearing securities of the U.S. government which are not exempt from Illinois taxation. This list includes items such as FNMA, GNMA and Freddie Mac securities, interest earned on federal refunds and repurchase agreements as well as others. For the full list and detailed descriptions refer to the regulation.

a) FNMA, GNMA, FREDDIE MAC

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Obligations (debentures, notes or bonds) issued by the Federal National Mortgage Association (FNMA), including mortgage-backed bonds issued under authority of 12 USC § 1719(d) and guaranteed by the Government National Mortgage Association (GNMA) under 12 USC § 1721(g), are not exempt from Illinois income taxation unless the obligation is defaulted upon and has been taken over by the Federal Assets Financing Trust or the Federal Assets Liquidation Trust.

Obligations issued by GNMA which are commonly referred to as GNMA "Pass-through Securities" or "Mortgage-backed Securities" are also not exempt from Illinois income taxation. These securities are actually issued by approved issuers and guaranteed by GNMA under 12 USC § 1721(g). This position was supported by the decision in the property tax case of the Rockford Life Insurance Co. v. Department of Revenue (Illinois).

The Federal Home Loan Mortgage Corporation (often abbreviated as FHLMC or Freddie Mac) was created on July 24, 1970 by the enactment of Title III of the Emergency Home Finance Act of 1970. Freddie Macs are principally mortgage pass-through securities called Freddie Mac Mortgage Participation Certificates and collateralized Mortgage Obligations. Both of these types of obligations are commonly referred to as Freddie Mac obligations.

The Federal Home Loan Mortgage Corporation, as an entity, is exempt from state taxation. However, the income received from the holding of Freddie Mac obligations is not exempt and should not be included in the Illinois subtraction modification.

b) Repurchase Agreements

Under a repurchase agreement, a corporation with excess cash will purchase an obligation from a financial institution or a securities broker. At the time of the purchase, an agreement will be made that the investment is very short-term in nature (generally less than six months but possibly as short as one day). The purchaser agrees to sell the obligations back to the bank or dealer within the specified period of time and the seller agrees to repurchase the obligations. The obligation is usually purchased and resold at a price, which is higher than the price the obligation would be traded on the open market. The higher price represents the original purchase price plus interest for the repurchase agreement period at the current market rate.

If the obligations used as collateral in the repurchase agreement are U.S. government obligations, corporations will, at times, include the repurchase agreement interest as U.S. interest in their Illinois subtraction modification. THIS IS NOT ALLOWABLE. The Department has consistently taken the position that the repurchase agreement is actually a loan by the corporation to the securities holder and the obligations are held by the corporation as collateral. As such, the interest which is earned on the U.S.

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government obligation is properly allowable as a subtraction modification to the financial institution or the securities dealer and not to the corporation. This position was upheld in the Andras case. For case synopses of the Andras case and the Loewenstein case (and complete case citations), refer to Chapter 49.

Generally, repurchase agreements have the following characteristics:

(1) The broker can recall the bond at any time by repaying the amount that was received from the taxpayer.
(2) The taxpayer can demand return of the original purchase price, regardless of market conditions, by releasing the taxpayer's hold on the bond.
(3) The taxpayer cannot sell the bond to anyone else, nor can the taxpayer refuse to release the bond if the broker chooses to recall it.
(4) The taxpayer never gains control of the bond; it is placed in a bank, picked by the broker, as security for the money invested.
(5) With the taxpayer's permission, the broker can exchange the deposited security for another, while retaining the invested money.
(6) The bond "purchased" by the taxpayer is usually not readily marketable by the broker; thus its value may or may not be equal to the investment made by the taxpayer.
(7) The interest rate to be paid to the taxpayer is based on the interest rate in the money market and is usually in excess of the interest rate authorized by the bond.
(8) The broker clips the interest coupons and redeems them, and also exchanges the security on deposit (with the taxpayer's permission) and cashes it with the federal government.

By applying the above criteria it can be determined if a taxpayer actually owns an obligation and therefore has a right to the U.S. Interest subtraction modification. The following are some additional clues to pinpointing repurchase agreements:

(9) The resale price is ALWAYS stated if the resale date is fixed, or is determined by a formula that reflects accrual of interest over the period between the purchase and resale if the resale date is not fixed.
(10) Obligations are ALWAYS purchased from and resold to the same person.
(11) Transactions are usually short term in nature (generally less than six months).
(12) Interest paid is usually higher than the stated rate.

8. Other Income Not Exempt From Illinois Income Taxation

a) U.S. Bond Gain Issue

Bond Gain refers to the capital gains realized on the sale of U.S. government obligations such as notes, bonds, debentures, etc. Even though not allowed by the

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Illinois Income Tax Act, some taxpayers include the gain in the subtraction modification for interest from U.S. government obligations. More information related to this is offered in the Historical Extracts section of this chapter.

b) Federal Home Loan Bank Dividends

Dividends (cash or stock) from the holding of federal home loan bank (FHLB) stock are not exempt from state taxation. Daily investment deposit (DID) accounts of federal home loan banks are not considered "other such obligations" and interest from such accounts is not exempt from Illinois income taxation. See compliance alert dated February 2010 on the IDOR web site. The Illinois Circuit Court of Cook County in the case of Bell Federal Savings and Loan Association also upheld the position that interest received on DID accounts is not exempt from state income tax. A synopsis of the Bell Federal case and a complete case citation can be found in Chapter 49.

In some cases, FHLB stock dividends are not included in federal taxable income. Instead, the FHLB stock dividends reduce the taxpayer's basis in the FHLB stock and the income is only included in federal taxable income when the FHLB stock is sold. In this situation, the FHLB stock dividends are shown as an adjustment on the taxpayer's schedule M-1 for income recorded on the books and records but not included in federal taxable income. Since the FHLB stock dividends are not included in federal taxable income and there is no addition modification for Illinois purposes requiring a taxpayer to add back an FHLB stock dividend, an FHLB stock dividend that is not included in federal taxable income is not subject to Illinois income tax.

c) Gross V. Net

(1) FOR TAX YEARS BEGINNING ON OR AFTER JANUARY 1, 1992

All interest which qualifies for the IITA § 203(b)(2)(J) subtraction modification should be eliminated from income in the computation of base income, net of premium amortization.

Beginning with tax year 2005, the IL-1120 was dramatically overhauled moving the Other Subtractions line to Step 3, Line 23. A Schedule M must be attached when an amount is entered on this line.

(2) FOR TAX YEARS BEGINNING ON OR AFTER JANUARY 1, 1991 BUT PRIOR TO JANUARY 1, 1992

The 1991 instructions to Line 5a of the IL-1120 (and corresponding lines of the other Illinois returns) were rewritten to state;

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Write the total interest received or accrued from U.S. Treasury bonds, notes, bills, and savings bonds that is included in federal taxable income. The amount is net of any bond premium amortization deducted federally.

The subtraction of Illinois tax-exempt interest, other than interest from the U.S. Treasury obligations referred to above was entered on Line 5f of the IL-1120. The Line 5f instructions were not changed to include the statement above. Therefore, the gross amount of interest (other than interest from U.S. Treasury obligations) which qualifies for the U.S. interest subtraction may be subtracted.

In 1991, three letter rulings were issued which stated that the U.S. interest subtraction modification should include the gross amount of U.S. interest received or accrued for the year. Those rulings: IT 91-0053, IT 91-0054 and IT 91-0103, were revoked on March 7, 1994, by letter rulings IT 94-0009, IT 94-0010 and IT 94-0011.

(3) FOR TAX YEARS BEGINNING PRIOR TO JANUARY 1, 1991

The subtraction modification allowed by IITA § 203(b)(2)(J) regarding income exempt from Illinois taxation due to Illinois or federal law is for the GROSS amount of interest received. No adjustment is to be made to this amount for expenses relating to the interest received. Specifically, the modification should NOT be adjusted for bond premium amortization.

F. ENTERPRISE / RIVER EDGE REDEVELOPMENT ZONE DIVIDENDS

(IITA § 203(b)(2)(K))

The organization must show that at least 95% of its business activity is within an enterprise zone (EZ) to qualify for the EZ dividend subtraction. The subtraction modification was expanded by Public Act 94-1021 effective July 12, 2006 to include corporations conducting operations in a River Edge Redevelopment Zone. With respect to a financial institution, refer to Chapter 30. Any distributions from a Subchapter S corporation conducting substantially all of its business operations in an Enterprise Zone or zones would not be deductible under IITA § 203(b)(2)(K) by the shareholders. Public Act 97-905 amended IITA § 203(b)(2)(K) by eliminating references to enterprise zones effective August 7, 2012. The subtraction will continue to apply to qualified river edge redevelopment zone dividends. Refer to 86 IAC § 100.2480(b) for more information. Subparagraph (K) is exempt from the provisions of IITA Section 250.

The formula used to apportion income of an organization is utilized in determining the percentage of business activity conducted within the EZ to apportion income between the EZ and all other locations. The apportionment formula may be found in IITA § 304.

When auditing a taxpayer that is claiming this subtraction it is important to verify that the dividends, net of any dividends-received deduction claimed for those dividends on the

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federal return (Line 29(b)) are subtracted, not gross dividend income. Only the amount of dividends included in taxable income may be subtracted here.

Also, the timing of the dividend payment is important. Qualifying dividends may only be subtracted if paid after the latest of:

1. The date the EZ or river edge redevelopment zone in which the corporation paying the dividends is located was officially designated by the Department of Commerce and Economic Opportunity (formerly Commerce and Community Affairs);

2. The date the corporation paying dividends commenced operations in the EZ or river edge redevelopment zone.

3. The effective date of the public act enacting this subtraction (December 7, 1982).

It is the responsibility of the auditor to verify each business location is within an EZ or river edge redevelopment zone. The auditor will first analyze the maps provided at the DCEO website:

http://www.illinois.gov/dceo/ExpandRelocate/Incentives/taxassistance/Pages/EZmaps.aspx

If a determination cannot be made, the auditor will submit the inquiry and documentation to the audit supervisor including:

- the exact street address,
- local business name and
- any additional information

This information will then be:

- forwarded to the Technical Support Supervisor,
- analyzed
- Technical Support will contact DCEO if needed
- final determination will be provided to the auditor by the audit supervisor

The subtraction is reported in Step 3 of the IL-1120 and calculated on an IL Schedule 1299-B using figures obtained from the federal Form 1120, Schedule C. Auditors will refer to the schedules listed to verify the amounts reported after confirming eligibility.

G. FOREIGN TRADE ZONE (SUBZONE)/HIGH IMPACT BUSINESS DIVIDENDS

(IITA § 203(b)(2)(L))

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This subtraction of "an amount equal to dividends paid by a corporation" is allowed to taxpayers whose:

1. Qualifications include

   a) Conducting business in a federally designated Foreign Trade Zone or Sub-Zone and
   b) Designation as a High Impact Business

Dividends subtracted under Section 203(b)(2)(K) may not be subtracted under this provision. Taxpayers are entitled to this subtraction in the taxable year in which qualifying dividends are included in taxable income of the taxpayer.

2. Limitations to this subtraction are:

   a) Distributions must be dividends,
   b) Only dividends that are included in federal taxable income of the taxpayer (for an individual, adjusted gross income) can be subtracted,
   c) The dividends are not eligible for the subtraction provided in IITA § 203(a)(2)(J), IITA § 203(b)(2)(K), IITA § 203(c)(2)(M), or IITA § 203(d)(2)(K), and
   d) The dividends cannot be subtracted under any other provision of IITA § 203.

The subtraction is reported in Step 3 of the IL-1120 and calculated on an IL Schedule 1299-B using figures obtained from the federal Form 1120, Schedule C. Auditors will refer to the schedules listed to verify the amounts reported after confirming eligibility. See 86 IAC § 100.2490 for more information.

H. INTEREST INCOME ON LOANS SECURED BY EZ PROPERTY

FOR FINANCIAL INSTITUTIONS ONLY
(IITA § 203(b)(2)(M))

A financial organization within the meaning of IITA § 304(c) qualifies for a subtraction modification for the amount included in its taxable income as interest income from a loan or loans the collateral of which is property which is "eligible" for the EZ Investment Credit or the River Edge Redevelopment Zone Investment Credit. Effective on and after August 7, 2012, interest received or accrued from a loan secured by EZ property does not qualify for the subtraction.

For information regarding this subtraction modification refer to the Financial Organizations Chapter 30 and 86 IAC § 100.2655. Subparagraph (M) is exempt from the provisions of IITA Section 250.

I. LOANS SECURED BY HIGH IMPACT BUSINESS PROPERTY

FOR FINANCIAL INSTITUTIONS ONLY

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(IITA § 203(b)(2)(M-1))

A financial organization within the meaning of IITA § 304(c) qualifies for a subtraction modification for the amount included in its taxable income as interest income from a loan or loans the collateral of which is property which is “eligible” for the High Impact Business Investment Credit and the operations of which are placed in a Foreign Trade Zone or Subzone within Illinois.

For information regarding this subtraction modification refer to the Financial Organizations Chapter 30 and 86 IAC § 100.2657.

J. CONTRIBUTIONS MADE TO DESIGNATED ZONE ORGANIZATIONS (DZO)

(IITA § 203(b)(2)(N))

1. Eligibility Criteria

There are two criteria, which must be met before a corporation can claim this modification.

a) The contribution must qualify as a charitable contribution under IRC § 170(c).
b) The corporation must have a certificate of approval from the Department of Commerce and Economic Opportunity (DCEO), (formerly Commerce and Community Affairs).
   (1) To apply for the deduction a corporation must fill out a Designated Zone Organization Corporate Contribution Application.
   (2) DCEO is providing the Department of Revenue with copies of any certifications issued.

The taxpayer needs to provide adequate proof of DCEO certification. If documentation is not available, contact the Technical Support supervisor.

2. Ineligibility Criteria

a) A debt, which is owed by a DZO to a creditor and is written off by the creditor, is not considered a charitable contribution eligible for the subtraction modification. The contribution must be used for a specific project approved by DCEO. By its nature, the cancellation of a debt is a general type of contribution and therefore, would not qualify.
b) The value of legal services rendered to assist a DZO in a project, which are donated as in-kind contributions, does not qualify for the subtraction modification.
c) Incubator or start-up businesses operating for profit do not qualify as a "project" of a DZO. Consequently, contributions to such operations would not qualify for the subtraction modification.
d) Grants received from the DCEO under the Illinois Coal Technology Development Assistance Act (ICTDAA) cannot be claimed as a subtraction modification. The

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ICTDAA itself, 30 ILCS 730/1 et seq., contains no provision exempting grants awarded there under from Illinois income taxation. IITA § 203(h) prohibits any subtraction that is not expressly allowed in IITA § 203.

The subtraction, effective December 7, 1982, is reported in Step 3 of the IL-1120 and calculated on an IL Schedule 1299-B using figures obtained from the federal Form 1120, Schedule C. Auditors will refer to the schedules listed to verify the amounts reported after confirming eligibility. Subparagraph (N) is exempt from the provisions of IITA Section 250.

K. FOREIGN SOURCE DIVIDEND SUBTRACTION

(IITA § 203(b)(2)(O))

The purpose of the modification is to tax foreign dividends in the same manner and amount as domestic dividends. Subparagraph (O) is exempt from the provisions of IITA Section 250.

- TY ending after December 31, 1992, the modification is for a percentage equal to the percentage allowable under IRC § 243(a)(1):
  - 70% if the dividends were received from less than 20% owned corporations
  - 80% if the dividends were received from 20% or greater owned corporations, but less than 80% owned
- TY ending on or after December 31, 1982, and prior to December 31, 1992, the modification is for:
  - 85% of the foreign source dividends included in taxable income that exceed the IITA § 203(b)(2)(G) modification [foreign dividend gross-up] plus
  - 100% of the dividends that exceed the IITA § 203(b)(2)(G) modification, and were received from a foreign entity that would be a member of the affiliated group which includes the dividend recipient, if it were not for the exclusion in IRC § 1504(b)(3)
- TY ending on or after December 31, 1988 the modification applies to the amount by which any dividends received or deemed received or paid or deemed paid under IRC §§ 951 through 964 [Subpart F income] exceed the foreign dividend gross-up related to such dividends.
- TY ending on or after December 31, 2008, the modification includes dividends received from a captive real estate investment trust

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IRC § 1504(b)(3) specifically excludes foreign corporations from the term "includible corporation". Prior to tax years ending on or after December 31, 1988, Subpart F income was not includible in this subtraction amount.

Corporate taxpayers report a breakdown of their dividend income on the federal Form 1120, Schedule C. Examination of federal Forms 5471 and 5472 will confirm ownership for foreign dividends claimed. For Illinois, IL-1120, Schedule J is used to compute the amount of the foreign source or REIT dividend subtraction allowed for a specific tax year. Although correct since 2005, this schedule was rife with errors in years prior. Those errors are outlined in the Appendix of this chapter.

1. Dividends from Multi-Tiered Foreign Corporations

A taxpayer claiming the 100% subtraction modification must directly own 80% or more of the foreign corporation, or one or more of the other members of the taxpayer's affiliated group must together own directly the requisite 80% or more of the foreign corporation. In determining whether the taxpayer qualifies for a 70% or 100% subtraction modification, the distribution must be a dividend from a foreign corporation, and thus the taxpayer must directly own stock of the distributing foreign corporation. In a string of multi-tiered foreign corporations, we would only look at the percentage of ownership in the first-tiered corporation to determine the percentage of dividends that qualified for the subtraction.

> For example, the taxpayer owns 85% of the stock in a foreign corporation (FC#1). FC#1 owns 65% of the stock in a second-tier foreign corporation (FC#2). The taxpayer's subtraction modification with respect to a distribution from FC#1 is not affected by the fact that the economic source of the dividend can be traced to FC#2. The taxpayer's subtraction modification depends on its relationship to FC#1. In this example FC#1 owns less than 80% of FC#2, but the dividends declared payable by FC#1 to the taxpayer still qualify for the 100% deduction because FC#1 is owned more than 80% by the taxpayer.

2. Dividends Flowing Through From A Foreign Partnership

Foreign dividends that are received from a partnership are much more complicated. Chapter 28 of the Audit Manual covers partnerships, Subchapter S corporations, trusts & estates. Refer to that Chapter regarding the rules for determining income and modifications for these taxpayers.

3. Subpart F Income

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In October 1991, the Illinois Supreme Court denied an appeal of an appellate court decision in the case of Kraft, Inc. v. The Illinois Department of Revenue. The appellate court held that, prior to the effective date of Public Act 82-1029, Subpart F income was not includible in the subtraction modification amount for foreign source dividends since the Subpart F income involved the undistributed income of subsidiaries that were controlled foreign corporations and not dividends actually received from those foreign sources.

For more information regarding the water's-edge combination method of reporting and unitary business groups in general, refer to Chapter 23. A synopsis of the Kraft decision and a complete case citation can be found in Chapter 49.

4. Foreign Dividend Flow-Through From A Mutual Fund

Dividends received by a taxpayer from a mutual fund such as Acorn International that invests exclusively in foreign corporations may not be claimed by the taxpayer as a subtraction modification for foreign dividends. Taxpayers have taken the position that it is an allowable subtraction modification because in the Andras v. Department of Revenue case a taxpayer that received a dividend from a mutual fund that invested U.S. Government securities was allowed a subtraction modification.

In Andras the Court allowed the subtraction modification to flow through to the taxpayer because there is a federal statute that provides that states cannot impose a direct or indirect tax on U.S. Government interest. If the taxpayers were not allowed a flow through of the U.S. Government interest, it would amount to an indirect tax. The theory applied by the Court in this case would not apply to any other type of income.

A similar issue occurs with interest on obligations of state and local governments that are specifically exempted by the IITA. 86 IAC § 100.2470(f) explains that the bond income is not exempt if they are owned indirectly through shares in a mutual fund. Although, it is not stated in the regulations, the same would be true for foreign dividends.

5. Captive REIT

The REIT addition modification in IITA § 203(b)(2)(E-15) could result in double taxation if the REIT holding company is subject to Illinois tax because the dividends received by the REIT holding company do not qualify for the federal deduction under IRC § 243.

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Note that a legislative error created different start dates for the addition and subtraction modifications.

Language was added to the Schedule J to allow dividends from a captive REIT to be included in the subtraction modification for tax years ending on or after December 31, 2008, while the addition modification is not required until after 2008. See Chapter 24 for an example of the related addition and subtraction modifications.

A consent dividend is a device to allow a RIC or REIT to meet its income distribution requirements after the end of the tax year, so it can continue to qualify as a RIC or REIT. Consent dividends are treated the same as other dividends paid by the RIC or REIT. REIT dividends are not deductible under IRC § 243 and RIC dividends can be deducted only to the extent they represent distributions of dividends that would qualify for the IRC § 243 deduction that are received by the RIC and that the RIC has certified to its shareholders, so treating consent dividends as true dividends rarely matters. However, consent dividends from a captive REIT are subtractable under IITA § 203(b)(2)(O), the same as other captive REIT dividends.

L. JOB TRAINING PROJECT CONTRIBUTIONS

(IITA § 203(b)(2)(P))

This modification is effective for tax years ending on or after January 1, 1986, and is equal to any contribution to a job training project related to the Tax Increment Allocation Redevelopment Act (TIARA). TIARA does not provide for a contribution program. The IITA subtraction modification assumes that TIF district taxpayers will contribute to such job training projects voluntarily.

When auditing a return, on which the Job Training Project subtraction modification is claimed, the following information should be obtained:

1. A written redevelopment plan for the TIF district or project area involved.

2. A copy of the job training project to which they have contributed.

3. A detailed list of the contributions made including the nature of the contributions and a description of how the contributions were appropriate to the described job training project.

4. A list of the persons being trained whether currently employed or prospectively employed in a redevelopment project area.

This subtraction modification is not for general training expenses of an employer located in a TIF District but for contributions to a specific TIF district project. If the taxpayer refuses to provide a written job training project agreement, the subtraction modification should be denied.

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Informational Bulletin FY 90-40 explains the Job Training Projects subtraction and is available on the Department website. Key elements of the modification are:

1. The contributions will NOT qualify for the modification if the contributions are reimbursed.

2. The subtraction must be taken in the year in which the contribution is made and applies only to contributions made on or after January 1, 1986.

The subtraction modification is reported in Step 3 on the 2005 (and subsequent) IL-1120.

M. CLAIM OF RIGHT

(IITA § 203(b)(2)(Q))

Available to any taxpayer that has taken a federal credit for amounts repaid under IRC § 1341 "claim of right." The subtraction is equal to the amount which would have been deducted from income had the federal credit not been claimed. If the taxpayer claims the deduction federally, no Illinois subtraction modification is allowed.

The claim of right doctrine applies where a taxpayer has an apparent right to unrestricted income. A possibility may exist at the time of receipt that repayment of all or part of the income will be required at a later date. Examples include:

- Amounts the taxpayer has contracted, before receipt, to pay to a person
- Illegal payments
- Amounts the taxpayer may repay voluntarily
- Amounts received under a mistake of fact
- Litigation awards
- Amounts received subject to a contingency

Income received under a claim of right must be reported in the year of receipt. Repayment of the income (or any part of the income) in a later year does not entitle the taxpayer to file an amended return for the earlier year. Instead, a deduction for the amount of the repayment is allowed in the year it is made if using a cash accounting method. Any other accounting method will require the credit be claimed only for the tax year in which it is a proper deduction under that method. In either case, IRC § 1341 allows many taxpayers to elect to claim a credit in lieu of the deduction for the year, with the credit being equal to the reduction in tax that would have resulted if the taxpayer had excluded the repaid amount from income in the year it was received or accrued.

The subtraction modification for the credit taken is reported on the IL Schedule M, in Step 3 (line 14 of the 2009 and subsequent forms). If an amount is included on this line, the auditor will request a copy of the taxpayer's Form 1139, Corporation Application for

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Tentative Refund, with the attached computation of the credit to verify the amount reported. Rarely, the taxpayer may report the credit on federal Form 1120X. In this instance, it should be reported in the Payments and Credits Section, on the Overpayment in prior year allowed as a credit Line, and a calculation sheet should still be available for review.

N. ATTORNEY-IN-FACT

(IITA § 203(b)(2)(R))

IRC § 835 allows an interinsurance or reciprocal insurance company and the attorney-in-fact that manages its business to elect to consolidate their operations for tax purposes. If the election is made, the reciprocal insurer is disallowed a deduction for the fees it pays the attorney-in-fact to the extent of the net income of the attorney-in-fact that is attributable to its activities on behalf of the reciprocal insurer. The reciprocal insurer is allowed a federal credit equal to the portion of the attorney-in-fact's federal income tax liability attributable to the income from its activities on behalf of the reciprocal insurer. If this election is made, the attorney-in-fact's income is included in taxable income on two separate returns, resulting in double Illinois taxation because Illinois has no credit provision. This modification eliminates the double tax by allowing the attorney-in-fact to subtract an amount equal to the expenses disallowed on the reciprocal insurer's federal return when the reciprocal insurer makes an IRC § 835 election. Subparagraph (R) is exempt from the provisions of IITA Section 250. Refer to Chapter 31 for additional information regarding this modification.

O. INCOME DISTRIBUTABLE TO SHAREHOLDERS SUBJECT TO REPLACEMENT TAX

(IITA § 203(b)(2)(S))

Applicable to tax years ending on or after December 31, 1997, in order to prevent the same income from being subject to replacement tax twice, Subchapter S corporations are allowed to deduct the portion of their net income that is distributable to a shareholder who is subject to replacement tax or to certain exempt organizations. Subparagraph (S) is exempt from the provisions of IITA Section 250. Refer to Chapter 28 for information regarding partnership, trust and estate returns.

P. FEDERAL BONUS DEPRECIATION

(IITA § 203(b)(2)(T))

IRC § 168(k) originally provided that taxpayers were to deduct "bonus depreciation" of 30% of the cost of capital assets acquired and placed in service after September 10, 2001, and before January 1, 2005. Taxpayers depreciate the remaining 70% of the cost using their normal depreciation method. For most assets, the normal depreciation is 70% of what the

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amount would be if no bonus depreciation were claimed. The bonus depreciation allowable on property placed in service after May 3, 2003, was increased to 50%.

IRC Section 168(k) has been amended several times, through the following Acts primarily to extend its application.

- Economic Stimulus Act of 2008
- American Recovery and Reinvestment Act of 2009
- Small Business Jobs Act of 2010
- American Taxpayer Relief Act of 2012
- Tax Increase Prevention Act of 2014
- Protecting Americans from Tax Hikes (PATH) Act of 2015

The most recent amendments reflect the intention of Congress to provide for bonus depreciation rules that are substantially identical to the bonus depreciation rules originally enacted in 2002 and 2003. A comprehensive set of regulations were promulgated in connection with the former rules. *See* 26 CFR § 1.168(k)-0 *et. seq*. The IRS in 2008 issued a notice confirming that the existing regulations continue to apply. See IRS News Release (IR-2008-58) (April 11, 2008).

Federally, bonus depreciation has generally been available since September 11, 2001, with a period of expiration in 2005, 2006, and 2007, and has ranged from 30 percent to 100 percent over the years as shown in this chart:

Start Date	**End Date**	**Bonus Rate**
09/11/2001	05/05/2003	30%
05/06/2003	12/31/2004	50%
01/01/2008	09/08/2010	50%
09/09/2010	12/31/2011	100%
01/01/2012	12/31/2017	50%
09/27/2017	12/30/2022	100% for qualifying assets

Public Act 92-603 effective June 28, 2002, “decoupled” Illinois from the federal legislation by reversing its effects on depreciation.

- First, it requires taxpayers to add back on their Illinois return, the federal bonus depreciation.
- Second, it allows taxpayers to deduct the additional depreciation amount that would have been allowed on their federal return if the bonus depreciation law had not been enacted. This subtraction is provided for corporations in IITA § 203(b)(2)(T). This

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deduction is allowed for each year that depreciation is claimed for an asset, not just for the year in which the bonus depreciation on the asset is added back.

- When the asset is disposed of or reaches the end of its depreciable life, the original add-back of the bonus depreciation deduction is subtracted and the subtractions under this subparagraph (T) are added back. So that the net effect of all the modifications is to change only the timing of depreciation deductions.

The auditor's primary responsibility will be to verify that the taxpayer does not claim too much subtraction modification on bonus depreciation previously reported as an addition modification. The reversal modifications, specifically subparagraph (E-11), will correct any over-reported bonus depreciation subtractions taken on the assets in prior years, open or closed. Based upon the language of the statute and the Duty of Consistency principle, the taxpayer must reverse the aggregate amounts actually reported and allowed under (T), not what they should have reported.

Subparagraph (E-11) cannot be used as a "catch-all correction". It may only be used to reverse reported and allowed (T) subtractions regarding specific assets that have either been sold, transferred, abandoned, disposed of, or fully depreciated.

As initially enacted, the modification in IITA § 203(b)(2)(T) assumed that the taxpayer had actually taken bonus depreciation equal to 30% of its basis in the property, so that its regular depreciation was computed on only 70% of the basis it would otherwise use. The depreciation deduction is therefore equal to 70% of what it would be if IRC § 168(k) had not been enacted. Multiplying the 70% times 0.429 equals 30%. This is the reduction in regular depreciation caused by taking the bonus depreciation. However, the amounts on Line 19 of the Form 4562 also include depreciation on other property, so we cannot simply multiply those amounts by 0.429 to compute this adjustment.

Q. BONUS DEPRECIATION - AFFECT ON FEDERAL GAIN & LOSS

(IITA § 203(b)(2)(U))

Under federal law, when an asset is sold the gain or loss on the sale of the asset is equal to the price, minus the cost of the asset, reduced by all depreciation deductions. By computing gains this way, taxpayers are allowed a deduction for the entire cost of the asset, either through depreciation or when the asset is sold. Whatever gain or loss is reported for federal purposes is reported for Illinois purposes as well.

After the Illinois modifications to bonus and regular depreciation are made, total Illinois depreciation on an asset that is not fully depreciated will be less than total federal depreciation. This means that if Illinois takes into account only the federal gain or loss on the asset without adjustment, taxpayers may be required to include in base income a

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greater amount of gain (or a smaller loss) than properly includible. To correct this problem, Public Act 92-603 added IITA § 203(b)(2)(E-11) and (U) which require all of the Illinois changes to bonus and regular depreciation for an asset to be reversed in the year the asset is sold or the last year that federal depreciation is allowed to the taxpayer on the asset. After the changes are reversed, total Illinois depreciation will equal total federal depreciation and taxpayers will have received the proper deduction with respect to the asset. Subparagraph (U) is exempt from the provisions of IITA Section 250.

Form IL-4562 is used to compute the modifications for bonus depreciation. The form must be attached to the Illinois return. If the Illinois tax return has already been filed, then the taxpayer must file an amended return. The IL-4562 must be attached to the amended return. Auditors should review the IL-4562, Step 2, Line 3 for accuracy and request any other documentation necessary to make a determination.

If an amended return reversing the bonus depreciation was filed by October 15, 2002, no penalties or interest were assessed on the resulting underpayment.

1. IL-1040 Filers

The computation of the federal bonus depreciation modifications can be different for IL-1040 filers because some individuals report their depreciation expenses on federal Form 2106 for Employee Business Expenses. Refer to Chapter 45 for information on Individual Income Tax audits.

2. Excess Subtraction Modifications

There are times when the subtraction modification for the bonus depreciation computed on Step 3, Line 8, of the IL-4562 can exceed the addition modification computed on Step 2, Line 1, of the IL-4562, but for 2001 the subtraction modification can never exceed the addition modification in Step 2 since it is the first year for the bonus depreciation. The subtraction modification could be greater in other years depending on timing differences; however, the subtraction modification can never be greater than the addition modification over a period of time.

> For example, for 2001, 2002, 2003 and 2004 the taxpayer reported addition modifications of $4,000,000 on Step 2, Line 2. The total subtraction modifications on Step 3, Line 8, over that same period cannot exceed $4 million. Unless additional bonus depreciation is allowed and claimed in

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subsequent years, the total subtraction modifications claimed on Step 3, Line 8, in all years from 2001 onward cannot exceed $4 million.

Note: Due to rounding, 42.9% is actually too high. The more precise subtraction would be 42.857%. As a result, total subtractions on Step 3, Line 8 of Form IL-4562 may eventually exceed total additions on Step 2, Line 1. For example, if $4,000,000 in bonus depreciation is added back and the property on which bonus depreciation was taken is fully depreciated by the taxpayer in later years, the total subtractions on Step 3, Line 8, will be $4,004,000.

However, correcting prior year errors can be tricky. We cannot "modify" certain modifications to address taxpayer errors in prior years to recapture them in a later year, beyond what the modification expressly provides.

For example, if taxpayer has over-reported its (T) subtraction in closed years by $300 million, we cannot simply recapture that $300 million in a current year under (E-11) unless it meets the reversal criteria for those over-depreciated assets.

The modifications under (T) and the reversal modifications (E-11) and (U) do allow for some restrictions on improper Illinois subtractions and ultimately the reversal of improperly claimed amounts, so as long as taxpayer continues to be an Illinois filer, we should be able to eventually correct the improperly subtracted amounts in closed years.

The reversal modifications, specifically subparagraph (E-11), will correct any over-reported bonus depreciation subtractions taken on the assets in prior years, open or closed. Based upon the language of the statute and the Duty of Consistency principle, the taxpayer must reverse the aggregate amounts actually reported and allowed under (T), not what they should have reported. REF: [redacted]

3. Expiration of the Federal Bonus Depreciation

The federal Job Creation and Worker Assistance Act of 2002 that created the bonus depreciation expired in 2004. However, there have been several other Acts extending the provisions of IRC § 168(k). The most recent Act passed relating to federal bonus depreciation has extended the provision through tax year 2026. Unless a new Act is ratified further extending the federal bonus depreciation, there will be no addition modifications after 2019; subtraction modifications will continue in succeeding years. See the example below, following the next issue.

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4. Federal Bonus Depreciation at 50%

The federal bonus depreciation started out at 30% for assets placed in service on or after September 11, 2001, but the percentage increased to 50% for certain assets acquired after May 5, 2003. Public Act 94-776 amended the IITA for tax years ending after December 31, 2005, to allow the subtraction of 100% of the federal depreciation deduction of an asset on which 50% bonus depreciation was claimed.

The following example illustrates how property acquired between May 5, 2003 and December 31, 2005 will be handled.

Example: As a result of the disallowance of the 50% Federal bonus depreciation, an asset for Illinois purposes will not get the full depreciation deduction over its life because of the 3/7 (.429) factor applied to the remaining federal deprecation not including the bonus depreciation. In the example below a $10,000, 5-year asset purchased in 2004 gets a 50% federal bonus depreciation deduction of $5,000 = ($10,000 x 50%) plus regular federal depreciation of $1,000 = ($5,000 x 20%) in 2004. For Illinois, the $5,000 bonus is added back to income and 3/7 of the regular federal depreciation, or $429 = ($1,000 x .429), is allowed as a deduction in 2004. For 2005 and later, the subtraction is equal to the regular federal depreciation of the asset.

	Add-back	Subtraction	
2004	5,000	429	($5,000 x 20% x .429)
2005	0	1,600	($5,000 x 32%)
2006	0	960	($5,000 x 19.2%)
2007	0	576	($5,000 x 11.52%)
2008	0	576	($5,000 x 11.52%)
2009	0	288	($5,000 x 5.76%)
Total	5,000	4,429	

There is no deduction for the remaining $571 in basis. However, all addition and subtraction modifications are reversed in the year the asset is disposed of, so over the

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life of the asset the taxpayer will be allowed to deduct the entire basis of the asset, either as depreciation or in determining the gain or loss on disposition.

5. Federal Bonus Depreciation at 100%

The 100 percent bonus depreciation provided under IRC § 168(k)(5) for property acquired after September 8, 2010 and before January 1, 2013, is effectively allowed by Illinois; no adjustments are required. Technically, the bonus depreciation must be added back, but, because the year in which the asset is placed in service is also the last year of its depreciable life, the taxpayer is also allowed to subtract in that year whatever bonus depreciation was added back. (REF: IL-4562 Instructions)

R. RELATED PARTY 80/20 AND NONCOMBINATION RULE

(IITA §§ 203(b)(2)(V), (W), (X) & (Y))
86 IAC § 100.2430

Public Act 93-0840 created new addition and subtraction modifications for related party transactions with 80/20 companies effective for taxable years ending on or after December 31, 2004. Public Act 95-0233 and Public Act 95-0707 for taxable years ending on or after December 31, 2008, expanded the modifications to include interest expenses, intangible expenses and insurance premium expenses incurred in transactions with a related party, foreign or domestic, that would have been a member of the unitary group if not for the prohibition in IITA § 1501(a)(27) that requires all members of the unitary group apportion their income under the same subsections of IITA § 304 (noncombination rule). Schedule 80/20, Related Party Expenses, was revised along with 86 IAC § 100.2430, Addition and Subtraction Modifications for Transactions with 80/20 and Noncombination Rule Companies. Effective for tax years ending December 31, 2017 and after, Public Act 100-0022 amended the IITA in a manner to affect related party addition and subtraction modifications by eliminating the aforementioned noncombination rule.

Related party expense modifications are reported on the IL Schedule 80/20. Auditors will review the schedule and any supporting documents to verify the modifications are calculated correctly. Subparagraphs (V), (W), (X) & (Y) are exempt from the provisions of IITA Section 250.

1. IITA § 203(b)(2)(V) allows a subtraction for:

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a) Any interest income (net of expenses) to the extent the payor had to add back the payment under IITA § 203(b)(2)(E-12),

b) Any income from intangible property (net of expenses) to the extent the payor had to add back the payment under IITA § 203(b)(2)(E-13), and

c) Any insurance premium income (net of expenses) if the payor had to add back its payment for the premium under IITA § 203(b)(2)(E-14).

2. IITA § 203(b)(2)(W), and (X) allow a person who is required to add back interest or intangible expenses paid to a related party under IITA § 203(b)(2)(E-12) or (E-13), respectively, to subtract any interest or intangible income received from the same related party, up to the amount of the addition. The purpose of these provisions is to require taxpayers to add back only net interest or intangible expense payments if there are payments being made both ways.

3. IITA § 203(b)(2)(Y) (for tax years ending on or after December 31, 2011) allows a taxpayer who was disallowed a deduction for premiums paid to subtract any loss it would have been allowed to deduct federally if not for reimbursements received on that insurance policy. If the taxpayer elects to take this subtraction, the insurer must add back the reimbursements paid.

S. SUBTRACTION FOR IRC § 965 INCOME

(IITA § 203(b)(2)(Z))

If the taxpayer received controlled foreign corporation (CFC) dividends qualifying for deduction under IRC § 965, federal taxable income should be recalculated without applying IRC § 965(e)(2)(A) (which provides that taxable income may not be less than nondeductible controlled foreign corporation dividends), and without regard to any net operating loss deduction. The taxpayer may claim the excess of actual taxable income over the recomputed amount. Subparagraph (Z) is exempt from the provisions of IITA Section 250.

The American Jobs Creation Act of 2004 added section 965 to the IRC. In general, and subject to limitations, IRC § 965(a) provides that a corporation that is a U.S. shareholder of a CFC may elect, for one taxable year, an 85% dividends received deduction (DRD) with respect to certain cash dividends it receives from its CFCs.

In IRC § 965(e)(2)(A), taxable income may not be less than the amount of nondeductible CFC dividends received during the election year. If this causes the taxpayer to lose the benefit of some deductions that would otherwise cause it to have a smaller taxable income (or even a loss), those lost deductions become a net operating loss that the taxpayer may carry back (when applicable) or forward. Prior to the enactment of Section 203(b)(2)(Z),

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the taxpayer would get no Illinois income tax benefit from these deductions because the net operating loss deduction would have to be added back.

For Illinois purposes, this subtraction modification is reported on Schedule M. For the 2011 and subsequent forms it is found on Line 32.

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V. EXHIBITS

The following pages contain examples of the 2012 IL-1120 and Schedule M, referencing line specific information on the subtraction modifications.

- Exhibit One, page 35 – 2012 IL-1120, IITA cite references
- Exhibit Two, page 36 – 2012 IL Schedule M page 1, IITA cite references
- Exhibit Two, page 37 – 2012 IL Schedule M page 2, IITA cite references
- Exhibit Two, page 38 – 2012 IL Schedule M page 3, IITA cite references

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Step 2: Figure your income or loss

1	Federal taxable income from U.S. Form 1120, Line 30. **Attach** a copy of your federal return.	1	.00
2	Net operating loss deduction from U.S. Form 1120, Line 29a. This amount cannot be negative.	2	.00
3	State, municipal, and other interest income excluded from Line 1.	3	.00
4	Illinois income and replacement tax deducted in arriving at Line 1.	4	.00
5	Illinois Special Depreciation addition. **Attach** Form IL-4562.	5	.00
6	Related-party expenses additions. **Attach** Schedule 80/20.	6	.00
7	Distributive share of additions. **Attach** Schedule(s) K-1-P or K-1-T.	7	.00
8	Other additions. **Attach** Schedule M (for businesses).	8	.00
9	Add Lines 1 through 8. This amount is your income or loss.	9	.00

Step 3: Figure your base income or loss

10	Interest income from U.S. Treasury and other exempt federal obligations.	10	203(b)(2)(J)	.00	
11	Enterprise Zone or River Edge Redevelopment Zone Dividend subtraction. **Attach** Schedule 1299-B.	11	203(b)(2)(K)	.00	
12	Enterprise Zone or River Edge Redevelopment Zone Interest subtraction. **Attach** Schedule 1299-B.	12	203(b)(2)(M)	00	
13	High Impact Business Dividend subtraction. **Attach** Schedule 1299-B.	13	203(b)(2)(L)	.00	
14	High Impact Business Interest subtraction. **Attach** Schedule 1299-B.	14	203(b)(2)(M-1)	.00	
15	Contribution subtraction. **Attach** Schedule 1299-B.	15	203(b)(2)(N)	.00	
16	Contributions to certain job training projects. See instructions.	16	203(b)(2)(P)	.00	
17	Foreign Dividend subtraction. **Attach** Schedule J. See instructions.	17	203(b)(2)(G)	.00	
18	Illinois Special Depreciation subtraction. **Attach** Form IL-4562.	18	203(b)(2)(T)&(U)	0	
19	Related-party expenses subtraction. **Attach** Schedule 80/20.	19	203(b)(2)(V) (W) (X)&(Y)		
20	Distributive share of subtractions. **Attach** Schedule(s) K-1-P or K-1-T.	20	203(b)(2)(S)	.00	
21	Other subtractions. **Attach** Schedule M (for businesses).	21	See Sch M	.00	
22	Total subtractions. Add Lines 10 through 21.			22	.00
23	**Base income or loss.** Subtract Line 22 from Line 9.			23	.00

STOP

A If the amount on Line 23 is derived inside Illinois only, check this box and write the amount from Step 3, Line 23 on Step 5, Line 35. You may not complete Step 4. (You must leave Step 4, Lines 24 through 34 blank.) ☐

B If any portion of the amount on Line 23 is derived outside Illinois, check this box and complete all lines of Step 4. See instructions. ☐

Step 4: Figure your income allocable to Illinois (Complete only if you checked the box on Line B, above.)

24	Nonbusiness income or loss. **Attach** Schedule NB.	24	.00		
25	Trust, estate, and non-unitary partnership business income or loss included in Line 23.	25	.00		
26	Add Lines 24 and 25.			26	.00
27	Business income or loss. Subtract Line 26 from Line 23.			27	.00
28	Total sales everywhere. This amount cannot be negative.	28			
29	Total sales inside Illinois. This amount cannot be negative.	29			
30	Apportionment Factor. Divide Line 29 by Line 28 (carry to six decimal places).	30	.		
31	Business income or loss apportionable to Illinois. Multiply Line 27 by Line 30.			31	.00
32	Nonbusiness income or loss allocable to Illinois. **Attach** Schedule NB.			32	.00
33	Trust, estate, and non-unitary partnership business income or loss apportionable to Illinois.			33	.00
34	**Base income or loss allocable to Illinois.** Add Lines 31 through 33.			34	.00

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Illinois Department of Revenue

2012 Schedule M

Attach to your Form IL-1120, IL-1120-ST, IL-1065, or IL-1041

Other Additions and Subtractions (for businesses)

Year ending

Month Year

IL Attachment No. 15

Step 1: Provide the following information

Write your name as shown on your tax return.

Write your Federal Employer Identification no. (FEIN)

Step 2: Figure your additions

Write the amount of

1	Capital gain taxed under IRC Section 852(b)(3).	1	.00
2	Notes, bonds, debentures, or obligations issued by the Governments of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands.	2	.00
3	Lloyd's plan of operation loss if reported on your behalf on Form IL-1023-C and included in your federal taxable income.	3	.00
4	Business expense recapture.	4	.00
5	Any other state's income tax deducted from federal taxable income **(Form IL-1041 filers only)**.	5	.00
6	Capital loss to be carried forward **(Form IL-1041 filers only)**.	6	.00
7	Credit taken on Schedule 1299-A or 1299-D for college savings plan contributions you made as an employer.	7	.00
8	Dividends paid by a captive REIT.	8	.00
9	Other additions - Identify each item.	9	.00
10	**Total additions.** Add Lines 1 through 9. Write the amount here and on your Form IL-1120, Line 8, Form IL-1120-ST, Line 21, Form IL-1065, Line 22 or Form IL-1041, Line 10. →	10	.00

Step 3: Figure your subtractions

Write the amount of

11	Exempt interest dividends paid by regulated investment companies (IRC § 852(b)(5)).	11	203(b)(2)(H)	.00
12	Notes, bonds, debentures, or obligations issued by the Governments of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands to the extent the amounts were required to be added back on Line 2.	12	203(b)(2)(J)	.00
13	Lloyd's plan of operation income if reported on your behalf on Form IL-1023-C.	13		.00
14	Income for which you claimed a credit under IRC § 1341.	14	203(b)(2)(Q)	.00
15	Expense deductions disallowed federally under IRC §§ 171(a)(2), 265, 280C, 291(a)(3), or 832(b)(5)(B)(i). Specify any amount relating to the following:			
a	Interest expenses relating to municipal income (IRC § 291)	a		.00
b	Interest and other expenses related to federally tax-exempt interest (IRC § 265)	b		.00
c	Bond premium amortization on federally tax-exempt bonds (IRC § 171)	c		.00
d	Expenses related to certain federal credits (IRC §280C)	d		.00
e	Reduction in insurance company reserves (IRC §832)	e		.00
f	Reduction in depreciation related to railroad maintenance credits (IRC § 45G)	f		.00
g	Gross income resulting from alternative energy credits (IRC § 87)	g		.00
16	Add Lines 15a through 15g.	16	203(b)(2)(I)	.00
17	Add Lines 11 through 14 and Line 16. Write the amount here and on Line 18.	17		.00

Schedule M (R-12/12) Page 1 of 4

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Step 3: Continued

18	Write the amount from Line 17.			18	.00
19	Interest on the following obligations of Illinois state and local government, only if included in Illinois income (see instructions). **Attach** a copy of the statement that identifies the payer and the amount of interest for each obligation.				
	a Illinois Housing Development Authority bonds and notes (except housing-related commercial facilities bonds and notes)	a	.00		
	b Illinois Development Finance Authority bonds, notes, and other obligations (venture fund and infrastructure bonds only)	b	.00		
	c Illinois Sports Facilities Authority bonds	c	.00		
	d Illinois Development Finance Authority bonds (only those issued under the Illinois Development Finance Authority Act, Sections 7.80 through 7.87)	d	.00		
	e Illinois Development Finance Authority bonds or Illinois Finance Authority bonds issued under the Asbestos Abatement Finance Act	e	.00		
	f Bonds issued by the Illinois Finance Authority under the Illinois Finance Authority Act	f	.00		
	g Southwestern Illinois Development Authority bonds	g	.00		
	h Illinois Power Agency bonds issued by the Illinois Finance Authority under Other Powers Article in the Illinois Finance Authority Act	h	.00		
	i Central Illinois Economic Development Authority bonds issued under the Central Illinois Economic Development Authority Act	i	.00		
	j Eastern Illinois Economic Development Authority bonds issued under the Eastern Illinois Economic Development Authority Act	j	.00		
	k Southeastern Illinois Economic Development Authority bonds issued under the Southeastern Illinois Economic Development Authority Act	k	.00		
	l Southern Illinois Economic Development Authority bonds issued under the Southern Illinois Economic Development Authority Act	l	.00		
	m Illinois Urban Development Authority bonds issued under the Illinois Urban Development Authority Act	m	.00		
	n Downstate Illinois Sports Facilities Authority bonds issued under the the Downstate Illinois Sports Facilities Authority Act	n	.00		
	o Western Illinois Economic Development Authority Bonds issued under the Western Illinois Economic Development Authority Bonds Act	o	.00		
	p Upper Illinois River Valley Development Authority bonds issued under the Upper Illinois River Valley Development Authority Act	p	.00		
	q Will-Kankakee Regional Development Authority bonds issued under the Will-Kankakee Regional Development Authority Law	q	.00		
20	Add Lines 19a through 19q.			20	203(b)(2)(J) .00
21	Add Lines 18 and 20.			21	.00

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Step 3: Continued

22	Write the amount from Line 21.	22		.00
23	Federally taxed Illinois state refund from prior years	23	203(b)(2)(F)	.00
24	Dividends received, including IRC § 78 Foreign Dividend Gross-up and subpart F income **(Form IL-1120-ST filers only)**	24		.00
25	Contributions made to a job training project. See instructions.	25	203(b)(2)(P)	.00
26	Reparations or other amounts received as a victim of persecution by Nazi Germany **(Form IL-1041 filers only)**	26		.00
27	Income eligible for a deduction by an attorney-in-fact under IRC § 835	27	203(b)(2)(R)	.00
28	Illinois Pre-Need Cemetery Sales Act trust income	28	203(b)(2)(J)	.00
29	Income earned by nuclear decommissioning trusts established under the Public Utilities Act	29	203(b)(2)(J)	.00
30	Recovery of items previously deducted on Form U.S. 1040 Schedule A, filed by the decedent (including refunds of any state and local income taxes, other than Illinois) **(Form IL-1041, Estate filers only)**	30		.00
31	Refunds of state income taxes added back in a prior year on Schedule M, Line 5 **(Form IL-1041 only)**	31		.00
32	IRC § 965 dividend subtraction	32	203(b)(2)(Z)	.00
33	Other eligible subtractions from Publication 101 that are not subtracted anywhere else. Identify each item._____	33	203(b)(2)(J)	.00
34	**Total subtractions.** Add Lines 22 through 33. Write the amount here and on Form IL-1120, Line 21, Form IL-1120-ST, Line 33, Form IL-1065, Line 33, or Form IL-1041, Line 24. →	34		.00

Schedule M (R-12/12)

This form is authorized as outlined by the Illinois Income Tax Act. Disclosure of this information is REQUIRED. Failure to provide information could result in a penalty.

Page 3 of 4

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VI. HISTORICAL EXTRACTS

A. U.S. BOND GAIN ISSUE 1988 - 1996

Three issues related to U.S. Bond gains include:

1. A deduction on an original return and/or a claim for refund filed for capital gains from the sale of any U.S. Government Obligations prior to May 24, 1996.
2. Losses carried forward or back which were increased because of the deduction for bond gain are included.
3. Bond premium amortization included in the U.S. Government Obligation subtraction modification prior to March 7, 1994.

If the audit includes the period of January 1, 1988 through May 24, 1996 (i.e. any tax year that includes any part of this period) for the bond gain issue or the period prior to March 7, 1994 for the bond premium amortization issue and the taxpayer has done the following:

1. Claimed a subtraction modification for the gains on the sale of U.S. government obligations or for gross interest,
2. Filed amended returns claiming a subtraction modification for the gains on the sale of U.S. government obligations or for gross interest, and/or
3. Carried Illinois net losses that are increased due to a subtraction modification for the gains on the sale of U.S. government obligations or for gross interest

The Auditor should allow the subtraction modification and make no adjustments for that issue in the audit. The capital gains should be allowed **without** netting out the capital losses. Adjustments should be made for all other issues.

If the taxpayer has not claimed the subtraction, filed amended returns or increased losses for the increased subtraction modification but has raised the issue during the audit, the adjustment should be allowed.

If the losses resulting from the subtraction of the bond gain are carried into 1997, 1998 or 1999, the Auditor should make adjustments to the losses to reflect disallowance of the subtraction, allow only the carry forward of any remaining loss and prepare the appropriate workpapers and audit schedules. However, those workpapers and schedules should not be given to the taxpayer until reviewed by Income Tax Technical Support personnel. The workpapers should be sent to the Supervisor, Income Tax Technical Support for review.

The Auditor should include the EDA-25s, supporting schedules for the subtraction modification and loss carry forward. Detailed schedules should be included that show the amount of the

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bond gain and/or premium amortization. In the case of insurance companies, Schedule D, Part 4 of the insurance company annual statement provides the necessary information. Companies other than insurance companies would report this information on Schedule D of the Form 1120. Also, any comments that would be helpful in reviewing the workpapers should be included. A note that states the date the statute will run should be prominently displayed on front of the package of workpapers.

A Technical Support Auditor will be assigned to review the case and return it with instructions for completion.

If the Auditor determines that the taxpayer has incurred gains on the sale of bonds but not claimed a subtraction modification for that gain or indicated that they want the adjustment made, the Auditor should keep silent. The taxpayer has filed the return correctly and no adjustments are needed.

If asked about the status of bond gain refund claims, the auditor should tell the taxpayer that no subtraction is allowed.

B. AUDIT ISSUES - BONUS DEPRECIATION

Form IL-4562 Instructions – 2001

It states on the IL-4562, Step 3, Line 5: "Write the total amount of depreciation allowance claimed on federal Form 4562, **Line 17**, plus Line 19, Column g, or Line 26, Column h**, for property for which you reported an addition modification** on Form IL-4562, Step 2, Line 1, for this tax year or any prior tax year." [emphasis added].

Then, on the 2001 U.S. Form 4562 for line 17 it states: "MACRS deductions for assets placed in service in tax years **beginning before 2001**." [emphasis added].

The language on the IL-4562 for 2001 indicates that the taxpayer can have amounts from line 17 of the Form 4562, but the Form 4562 for 2001 indicates that this does not apply for the 2001 year. The explanation for this is that the IL-4562 is intended to be a multi-year form. Even though you wouldn't include Line 17 amounts on the IL-4562 for 2001, you would for succeeding years. If the taxpayer is including Line 17 amounts on the IL-4562 for 2001, then the taxpayer isn't following the instructions where it says "for property for which you reported an addition modification."

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IL-4562, Step 3, Line 5 Instructions:

The IL-4562, Step 3, Line 5 says: "Write the total amount of depreciation allowance claimed on U.S. Form 4562, Line 17, plus Line 19, Column g, or Line 26, Column h, for property for which you reported an addition modification on Form IL-4562, Step 2, Line 1, for this tax year **or any prior tax year.** [Emphasis added]. Some taxpayers are claiming that this means they can claim a subtraction modification on all bonus depreciation deductions from prior years. The response from Legal Services is:

"Prior years' depreciation deductions are not reported on Line 5. Only the current year's depreciation deductions on property for which bonus depreciation was claimed (whether the bonus depreciation deductions were claimed in the current year or a prior year). What Illinois law does is to disallow the 30% bonus depreciation in the first year. And instead, 30% of the basis of the asset is depreciated over the normal recovery period that applies to the asset. The purpose of Line 5 is to figure the Illinois depreciation deduction that applies to the 30% adjusted basis of the property." (Ref: Email response from Legal Services dated February 6, 2004).

The biggest problem that Audit is having with the IL-4562 is in Step 3 above where taxpayers are claiming 100% of the amounts from Lines 17, 19 and 26 on the Form 4562. Based on examples of problem IL-4562's that auditors have sent in, the amounts that should be picked up on the IL-4562 should include only a portion of these federal amounts. Unfortunately, many taxpayers who complete their own state returns only have one or two people in their tax department and therefore do not have hours to spend completing a particular state schedule. They may simply pick up 100% of the federal line reference even though they are aware that the amounts include depreciation on assets for which no bonus depreciation was claimed.

If this is the case and the taxpayer has made no effort to identify what amounts were claimed for the bonus depreciation assets, then the auditor will have to examine federal workpapers that support Lines 17, 19, and 26 on the Form 4562 and determine what amounts were reported for the bonus depreciation assets. This can be particularly challenging where there are many subsidiaries since the bonus depreciation is applicable to all companies – Illinois filers as well as non-filers. Since other states have also reversed the effects of the bonus depreciation, the auditor could compare the Illinois bonus depreciation on the IL-4562 with amounts reported on other state returns; however this will not work with states like California which have their own method of computing federal depreciation. If the taxpayer is unwilling or unable to document to the satisfaction of the auditor all of the items of depreciation expense on Lines 17, 19, and 26 on the Form 4562 that relate to assets for which bonus depreciation was added back, then the subtraction should be disallowed for any item of depreciation that is not documented.

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VII. APPENDIX

A. SCHEDULE J – ERRORS FOR 2004

Column B, Lines 5 and 6 of the 2004 Schedule J were mistakenly shaded, and as a result, taxpayers may not have made entries to those lines when they were legally required to. If the taxpayer did not report any amounts on Columns A or C, Lines 5 and 6, no action is needed.

If 2004 is an audit year, and amounts are entered on Lines 5 and 6 of the pre-printed 2004 Schedule J, the auditor must secure a corrected copy of the Schedule J for 2004 (using the 2005 Schedule J available on-line) and mail it to the Income Tax Technical Support supervisor.

The auditor cannot include the additional tax associated with the 2004 Schedule J error on the IL-870 because this tax increase is subject to the math error provisions under IITA § 903(a). Taxpayers do not have any rights to protest this math error. However, auditors must abate the late pay penalties associated with this tax. For more information regarding the 2004 Schedule J error refer to Informational Bulletin FY 2006-10.

B. SCHEDULE J – ERRORS FOR 1996 THROUGH 2002

Some of the line items on the Schedule J reflect the wrong percentages allowed under IRC § 243(a)(1). Basically the taxpayer is entitled to the foreign dividend subtraction in the following percentages:

- 70% deduction if the dividends are received from less than 20% owned foreign corporations.
- 80% deduction if the dividends are received from 20% or greater, but less than 80% owned corporations
- 100% deduction if 80% or more of the stock is owned.
- 100% on all foreign dividend gross-up

Auditors should refer to the 2003 IL-1120 Schedule J that was changed to reflect the proper percentages.

The Schedule J is essentially unchanged for calendar years 1996 through 2002. The following is a summary of the amounts that are included on the Schedule J along with an explanation of the errors on the form itself.

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Amounts from the following lines of the U.S. Schedule C are entered on the Illinois Schedule J:

Schedule J, Line 3

The U.S. source portion of dividends that are received from 20% or more owned foreign corporations and that qualify for the 80% deduction under IRC § 245(a) are entered on this line from U.S. Schedule C, Line 7. Dividends which are received from a 20% or more owned FSC that are attributable to income treated as effectively connected with the conduct of a trade or business within the United States (excluding foreign trade income) and that qualify for the 80% deduction provided in IRC § 245(c)(1)(B) are also included on this line.

a) Schedule J, Line 3 Error:

This line states: "Write the portion of Line 7 that is from less than 80% owned foreign corporations". Column D should show the allowable percentage of 80% - not 70%. The dividends on Line 7 of the Form 1120, Schedule C are received from 20% owned, but less than 80% owned corporations, therefore there is no 70% limitation on any of these dividends. Refer to the 2003 Schedule J.

b) Schedule J, Line 6 Error:

This line states: "Write the portion of Line 13 that is from less than 80% owned foreign corporations". The percentage listed in Column D is 70%. The allowable subtraction is limited to 70% only if the dividends were received from less than 20% owned corporations. The 2003 Schedule J breaks down this line between:

- Dividends received from less than 20% owned foreign corporations and
- Dividends received from 20% or more owned corporations, but less than 80%.

If the dividends are from greater than 20% or more owned, but less than 80% owned corporations, the subtraction modification is 80%. If the dividends are less than 20% owned, then the subtraction is limited to 70%.

c) Schedule J, Line 8 Error

Same as Line 6 above except this line is for dividends reported on the Form 1120, Schedule C, Line 14. The dividends on this line are subject to a 70% deduction only if they are from corporations less than 20% owned. Otherwise they get an 80% deduction if they are from corporations greater than 20% or more owned, but less than 80%.

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The auditor will have to breakdown the amounts reported on Schedule J Lines 6 & 8 based on the percentage of stock ownership, same as on the 2003 Schedule J.

For years prior to 1996, auditors will have to create their own schedules to reflect the above percentages keeping in mind the 85% limitation for years ending before 12/31/1992.

Note: Auditors should apply the correct percentages to the foreign dividends and allow any claims that are generated.

C. SCHEDULE J – ERRORS FOR 1993 AND 1994

The 1993 and 1994 Schedule J's contain two errors. The form allows taxpayers to incorrectly subtract 100% of certain dividends and makes a distinction between corporations that are less than 20% owned and those that are at least 20% owned but less than 80% owned.

a) Incorrect Allowance of 80% subtraction on certain dividends

The error is on Line 1c, Column B. The Schedule J allowed a taxpayer to subtract 80% of these dividends. The amount should be 70%.

b) Incorrect allowance of 100% subtraction on certain dividends:

The problem lies in Line 3 of the Schedule J. The form instructs the taxpayer to multiply the dividend amount in Line 3, Column B by 100% even though these dividends have been identified as only qualifying for the 70% subtraction. Therefore the Schedule J for both 1993 and 1994 erroneously allowed a taxpayer to claim a greater subtraction modification than is statutorily provided.

The errors on the Schedule J have been corrected on the 1995 version of the form. In audit, the subtraction modification for foreign source dividends for 1993 and 1994 should be recomputed, based on the correct subtraction percentages. Technical Support should be contacted on any case where the taxpayer is going to disagree to the liability resulting from the recalculation.

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NONBUSINESS/TRUST, ESTATE, NON-UNITARY PARTNERSHIP INCOME

Revised 10/2014
Reviewed 3/2020

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I. PURPOSE

To assist auditors in making a determination of base income or loss allocable to Illinois as defined in Article 3 of the Illinois Income Tax Act (IITA). General rules are presented in IITA § 301 with regard to allocation and apportionment of base income. Apportionment is discussed in Chapter 27 of the Audit Manual.

II. REFERENCE SOURCES

A. Illinois Income Tax Act

IITA § 203
IITA § 301
IITA § 303
IITA § 304
IITA § 305
IITA § 306
IITA § 307
IITA § 308
IITA § 1501

B. Illinois Regulations

86 IAC § 100.2405
86 IAC § 100.3010
86 IAC § 100.3015
86 IAC § 100.3500

III. GENERAL INFORMATION

A. Attribution of Income

Unless the company's base income is derived solely from Illinois (in which case 100% of its base income is taxable in Illinois) or the special attribution rules of IITA § 304(f) are in effect, the attribution of income is accomplished by using:

- Allocation rules in IITA § 301(c) and IITA § 303
- Apportionment rules in IITA § 304.

Before these rules can be applied, the auditor must properly classify income as either business or nonbusiness in nature. Taxpayers may claim certain items as business income in order to apportion the income to Illinois. This would be to a taxpayer's benefit if the

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commercial domicile is in Illinois or if the property from which the income is received is located in Illinois.

It is also possible for a specific item of LOSS to be considered nonbusiness in nature. The loss would then be allocated to the appropriate state in the same manner as nonbusiness income. Nonbusiness income is reported in Step 4 of the 2012 IL-1120.

B. Partnerships, S-Corps, Trusts and Estates

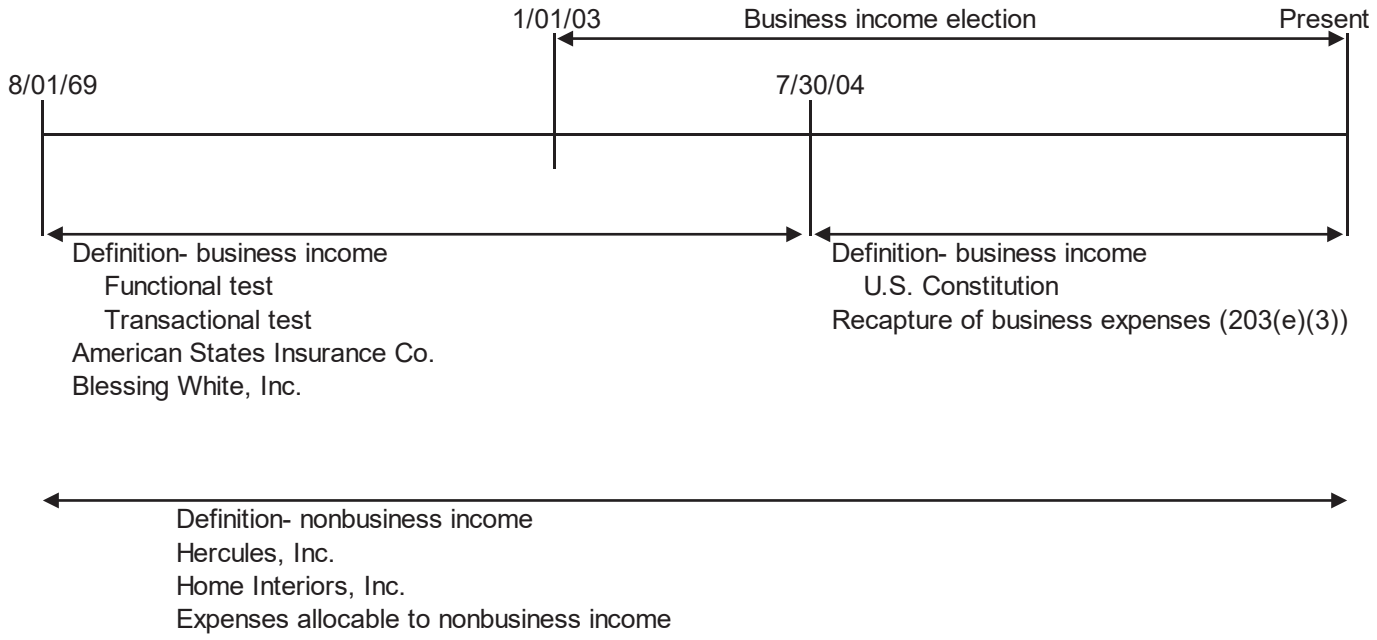
Chapter 28 of the Audit Manual covers partnerships, Subchapter S corporations, trusts & estates. Refer to that chapter regarding the rules for determining income for IL-1065 (Partnership), IL-1120ST (S Corp) or IL-1041 (Trusts and Estates) filers. Discussion on this topic within this chapter will focus on the amount of business income or loss from these taxpayers as allocable to Illinois.

1. Partnership income for nonresident partners is attributed in accordance with IITA § 305 (IAC § 100.3500),

2. Estate and trust income is attributed in accordance with IITA §§ 306 and 307.

3. S corporation income is attributed in accordance with IITA § 308.

IV. APE SPECIFIC LAW APPLICATION



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A. Business Income Election Effective 1/1/2003

IITA § 1501(a)(1) states that for each taxable year on or after January 1, 2003, a taxpayer may elect to treat all income, other than compensation, as business income. A check box was added to Step 1 of the IL-1120 for the taxpayer to make the election. If the box is checked, there should be no amounts on the income tax return for nonbusiness income. IAC § 100.3015 provides guidance for the election such as the following:

- Must be on the original return, or on a corrected return filed by the due date (including extensions) and is irrevocable.
- Each tax year stands on its own. For instance, for calendar year 2018 the taxpayer could elect to treat all income as business income. The election for 2018 would be irrevocable but would not apply to subsequent years.
- In the case of a partnership, trust, estate, or subchapter S corporation, an election made by such pass-through entity return is binding on its partner, beneficiary or shareholder. However, if the partner, beneficiary, or shareholder elects to treat all income as business income, then all nonbusiness income received from the partnership, trust or estate, or subchapter S corporation will be treated as business income.
- The election made by a designated agent is binding on all members required to join in a combined return.

Example: For 2018 Illinois corporate filers A, B and C file an IL-1120 combined return with the designated agent electing to treat all income as business income. Corporation D was not included in the unitary group and filed its own IL-1120 reporting nonbusiness income of $10,000. Upon audit an adjustment is made to include Corporation D in the combined return. Although Corporation D did not make the election to treat all income as business income, all of its income is automatically business income since it should have been a member of the combined return and the designated agent had made the election.

B. Nonbusiness Income

The taxpayer bears the burden of proof to show that income was properly classified as nonbusiness on its return.

1. Transactions Occurring On or After July 30, 2004

P.A. 93-840 changed the IITA § 1501(a)(1) definition of business income to all income that may be treated as apportionable business income under the Constitution of the United States. This is further discussed after the next section.

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2. Business Expense Recapture

If a taxpayer claims any item of income (federal Form 1120, Lines 1 through 10 of page 1) as nonbusiness income, and if in earlier years the taxpayer reported the same item as business income, then all related business expenses, without limitation, for the current year and the two preceding taxable years must be recaptured in the current year. Although IITA § 203(e)(3) refers to the recapture of business expenses on "disposition of an asset or business", it is not necessary to have a sale of an asset to trigger the recapture of business expenses. Recapture will occur only when an item of income has been treated as business income in the prior year **and** is being treated as nonbusiness income in the current year. Note that recapture is triggered when a taxpayer makes the election to treat all income as business income in one year, and then fails to make that election in a subsequent year, so that the same item of income or income from the same asset or business is treated as business income in the year to which the election applies and as nonbusiness income in the year no election is made. 86 IAC § 100.2405.(d)(1).

Recaptured expenses are reported as an addition modification to the current year's return along with a corresponding increase to nonbusiness income reported on the Schedule NB. The recaptured expenses are reported as an adjustment to Illinois nonbusiness income based on the total recaptured expenses times the Illinois apportionment factor that is either a three-year average factor or the current year's apportionment factor, whichever is greater. The recapture amount is calculated on IL Schedule NB, Line 11 and reported with the nonbusiness income or loss allocable to Illinois (IL-1120, Line 32 of the 2012 form). Refer to Chapter 25 for in-depth discussion and an extensive example of business income expenses recapture. Also, see IITA § 203(e)(3) and IAC § 100.2405(d) for more information.

3. The U.S. Constitutional Standard

The constitutional standard for determining whether an item of income is business or nonbusiness consists of two distinct tests:

- Unitary Business Relationship Test
- Operational vs. Investment Function Test.

a) Unitary Business Relationship Test

Income earned from property located or activities conducted outside the taxing state may be apportioned if the taxpayer is engaged in a unitary business enterprise. Whether a unitary relationship exists will depend on traditional unitary principles as applied to the facts and circumstances of a particular taxpayer. Unitary determination is explained in Chapter 23. Although Illinois still requires a corporation unitary group member to be owned more than 50% for a combined return, the Constitution does not require majority ownership. Under the Constitution, a unitary relationship can exist as long as there is evidence of:

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(1) strong centralized management,
(2) functional integration and
(3) economies of scale

b) Operational vs. Investment Function Test

The distinction between an investment function and an operational function depends on the relationship between the asset generating the income and the taxpayer's trade or business.

- Operational function - there is a connection between the asset and the taxpayer's existing business activity in the state
- Investment function – the asset has no existing relationship to any ongoing business activity.

An operational function can exist, even though no unitary relationship existed between the payor and payee. In order for an asset to be deemed operational, the taxpayer must have, while owning the asset, used it in its trade or business. What constitutes "use" is largely undefined, except that "use" is not synonymous with "available." An asset must actually be put in use for, or applied to, a known purpose that is related in some way to the taxpayer's trade or business. For example, interest earned on a bank account used as working capital is business income, and gain on the sale of futures contracts used to guarantee a price for raw materials is business income. Therefore, assets that are specifically set aside for working capital have a business purpose in addition to generating income. Income generated from assets that do not have a specified purpose other than to generate income will probably constitute nonbusiness investment income.

Example: An Illinois domiciled manufacturer has most of its operations in Illinois. In 2018 all of the stock is sold under IRC § 338(h)(10) resulting in a gain of $10 million. The taxpayer treated the gain as nonbusiness income. With the new definition of business income the structure of the transaction is irrelevant. Under the Constitution, all that is needed is some link between the income and the taxpayer's business activities in Illinois. Even if the taxpayer has nexus, the income still must somehow relate to the in-state activities to satisfy constitutional considerations. In this case, because the assets were previously used in operations, the gain should be treated as business income. In order for the gain to be considered nonbusiness under the new definition of business income the gain would have to relate to a separate line of business with no connection to Illinois.

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4. Transactions Prior To July 30, 2004

Three tests determined whether income was business or nonbusiness in nature:
a) Unities;
b) Transactional; and
c) Functional

Meeting either the transactional test or functional test resulted in business income under Illinois's statutory definition.

a) Unities Test

This test evolved as a result of Federal Supreme Court decisions in such cases as

- Mobil Oil Corp. v. Commissioner of Taxes,
- ASARCO Inc. v. Idaho State Tax Comm., and
- F.W. Woolworth Co. v. Taxation and Revenue Dept.

If the source of the income was the result of activities between entities involved in a unitary relationship then it was business income. To determine if the income was from a unitary source, the recipient's trade or business must be established. A person may have more than one "trade or business." If the income in question was received from a source which had a unitary relationship with any of the "trades or businesses" of the recipient, the income was considered business income.

For determining business income, the main criterion for establishing a unitary relationship was:

- functional integration through the exercise of
- strong centralized management.

  - Common ownership was not required.
  - Entities were not required to use the same apportionment formula (as prescribed in IITA § 304).
  - 80% or more of their business activities could be outside the United States.
  - Entities were not required to be in the same line of business or to be vertically integrated.

If a unitary relationship existed and the entities involved were determined to be members in the same unitary business group, any intercompany income and/or expense amounts should have been eliminated in the computation of unitary taxable income.

Refer to Chapter 23 Unitary Determination, for more information regarding:

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- what constitutes functional integration,
- what a unitary relationship is, and
- examples of the supporting documents, records and evidence needed to support a decision that a unitary relationship exists,

b) The Transactional Test

This test was derived from the first part of the definition of business income in IITA § 1501(a)(1) which stated that business income arose from transactions and activities which occur in the regular course of the trade or business. It included any activities of a person, which were performed in the normal course of business activities. The frequency and regularity of the activities may or may not be a decisive factor depending on the nature of the activity.

(1) Companies that routinely bought and sold other businesses

Buying and selling other businesses could constitute a regular business activity for purposes of the transactional test. See:

- PPG Industries Inc. v. Department of Revenue,
- Atlantic Richfield Co. v. State of Colorado,
- Kimberly Clark Corporation and Kimberly-Clark Worldwide, Inc. v. Alabama Department of Revenue

For any transactions except for IRC § 338(h)(10) elections, if an auditor believes that the gain in question should be re-classified as business income under the transactional test, the auditor must gather information regarding the nature and frequency of business acquisitions and dispositions over a period of time.

(2) Working Capital

Income from the temporary investment of working capital pending the use of the funds in the business generally constituted operating, business income. See:

- Howard Johnson Co. vs. Illinois Department of Revenue (short-term, business)
- Dover Corporation et al v. the Illinois Department of Revenue (long-term, nonbusiness)
- Allied-Signal, Inc. v. Director, Division of Taxation, New Jersey
- Home Interiors & Gifts, Inc., v. Illinois Department of Revenue (short-term, nonbusiness)

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Investments, which lie between the two extremes of the business and nonbusiness spectrum, must be examined and a determination made based on which side of the spectrum the specific investment tends to fall.

c) Functional Test

This test was derived from the second phrase in the statutory definition that business income was "income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." The infrequency or extraordinary nature of the transaction was irrelevant in determining if the resulting income was business or nonbusiness.

If a corporation sold property which it previously used in its business operations, the gain from the sale of the property was business income. An exception to this rule was if the property had been taken out of the production of business income prior to its sale. One indication that a particular piece of property was used in the production of business income is if it was included in the property factor.

Some of the rules and examples for determining if income is business or nonbusiness in nature contained in IAC § 100.3010(c) involve the functional test.

In *Blessing/White, Inc. v. Zehnder*, the court surmised that the modified functional test applied when the disposition of assets was made pursuant to a corporate liquidation in cessation of business. Under the liquidating sale exception to the functional test a complete liquidation and cessation of a separate line of business, where the proceeds were not used in furtherance of any ongoing concern but distributed in their entirety to shareholders, the gain was treated as nonbusiness income. If both the asset and the proceeds were used in the business, then the gain was classified as business income under the functional test.

(1) Short-Term Investments

The taxpayer must prove that it did not use the funds in its business. In order to successfully challenge this classification, the auditor must determine the true nature and use of the funds in question. The following factors should be considered where working capital funds have been segregated and/or classified as “excess working capital”:

- Are the “excess working capital” funds invested in a similar manner as the other working capital funds?
- Does the taxpayer have an investment plan in which the “excess working capital” is an integral part?

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- What is the type and maturity of investments in “excess working capital” funds?
- How are these funds classified on internal documents?
- How are these funds classified on public documents (i.e., annual reports, form 10-K, etc.)?
- What is the frequency of transactions involving the “excess working capital” funds? What is the source of deposits and use of funds dispersed?
- What is the likelihood that these funds would be used in the ordinary course of business given the nature of the taxpayer’s business?
- Did the taxpayer also classify these funds as “excess working capital” funds on other state tax returns? This is especially important with respect to the taxpayer’s business domicile.
- Were these funds earmarked for future use in the taxpayer’s business?
- How did the taxpayer determine its “excess working capital”?

The central focus of the inquiry is to determine if the taxpayer’s classification of funds as “excess working capital” is artificial. In order to make this determination, an in-depth examination, including proper documentation, is necessary to evaluate the true nature of the funds and determine whether they are being used in the taxpayer’s ordinary course of business.

d) Deemed Asset Sales

IRC § 338(h)(10)

Every 338(h)(10) transaction will involve a deemed liquidation of the target corporation. The object of the audit will be to identify the taxpayer and whether the other *Blessing/White* elements are satisfied.

(1) Sale of Unitary Subsidiary

When a consolidated group is involved, auditors should investigate whether the recipient of the proceeds (1) terminated a separate line of business, and (2) reinvested the gain in its ongoing business operations. If the liquidation did not represent a complete cessation of a separate line of business, as in *Texaco-Cities*, or the proceeds were used in the continuing business operations, such as for working capital needs or paying down debt, as in *Mead*, then the gain should be classified as apportionable business income consistent with those decisions.

(2) Sale of Non-unitary Subsidiary.

In cases like *American States*, where the target is a separate filer which distributes the proceeds to a non-unitary shareholder, the gain should be treated as nonbusiness income.

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C. IAC § 100.3010 Specific Income Items

IAC § 100.3010(c) provides rules and several examples for determining whether specific items of income are classified as business or nonbusiness. Some of these rules and examples incorporate the transactional test while others involve the functional test. Documentation to support the classification of each type of income as business or nonbusiness is discussed in the Exhibits section of this chapter.

1. Rental Income-
   IAC § 100.3010(c)(2)

Considered business income if the property with respect to which the income was received is used in the person's trade or business or is attendant thereto.

Rental income from safe harbor leases is considered business income. The safe harbor leases are (presumably) entered into for business reasons to minimize expenses and maximize federal tax incentives, and therefore any income arising from such lease is income arising from transactions and activity in the regular course of the taxpayer's trade or business and constitutes business income. See Kewannee Industries, Inc. v. Reese, 114 N.M. 784; 845 P.2d 1238 (1993)

2. Gains or Losses From the Sale of Assets-
   IAC § 100.3010(c)(3)

Constitutes business income if the property, while owned, was used in the trade or business. If utilized in the production of nonbusiness income, not used during an extended period of time prior to sale (normally 5 years) or was removed from the property factor before its sale, the gain or loss constitutes nonbusiness income.

Gains or losses from the disposition of the stock of a subsidiary will be considered to be business income if the subsidiary was in a unitary relationship with the parent. If the unitary relationship did not exist the gains or losses may still be considered business income if the income is earned in the course of activities related to those carried out in Illinois.

Gains or losses from the disposition of a non-unitary subsidiary's stock may also be considered business income if the taxpayer is in the business of buying and selling businesses. In such a case, the taxpayer would be considered to be in the separate

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unitary business of investing in businesses and be entitled to business income treatment of capital gains and dividends even though the business of the underlying subsidiaries is not unitary.

Gains or losses from the disposition of stock of unrelated corporations will be considered to be business income if the corporations are in a unitary relationship with the holder of the stock OR if the earning of the income forms part of the taxpayer's unitary trade or business.

3. Interest-
IAC § 100.3010(c)(4)

Is business income if the intangible is held or was created in the regular course of the trade or business operations or if the purpose for acquiring or holding the intangible is related or attendant to such trade or business.

4. Dividends-
IAC § 100.3010(c)(5)

When the stock with respect to which dividends are received is held or was acquired in the regular course of trade or business operations or if the purpose for acquiring or holding the stock is related or attendant to trade or business operations, they are classified as business income.

Per the instructions to the IL-1120 under General Information, Part 1--Who Must File, corporate shareholders of a DISC or FSC will include actual and deemed distributions from the DISC or FSC in business income. (References to the FSC were added in the 1985, IL-1120 instructions.)

Dividend income is considered business income if the payor and the recipient are unitary. If the payor and the recipient are members of the same unitary group the dividend income will be eliminated as an intercompany transaction. If the dividends are received from foreign subsidiaries, a portion (if not all) of the dividend income will be eliminated as a subtraction modification to taxable income.

5. Royalties-
IAC § 100.3010(c)(6)

If the patents or copyrights are held or were created in the regular course of trade or business or the purpose for acquiring or holding the patents or copyrights is related or

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attendant to the trade or business operations, then royalties paid are considered business income.

6. Covenant Not To Compete-

Private letter ruling (IT-99-0005-PLR) issued 7/12/99 indicated that, in the absence of facts to the contrary, income from a covenant not to compete is business income.

7. Subpart F Income-

For tax years ending prior to December 31, 1988, Subpart F income was included in base income and was presumed to be business income. REF: Director's Decision for PAT #7 dated December 10, 1991. For subsequent years, corporations are allowed to subtract Subpart F income as part of the foreign dividends received subtraction in IITA Section 203(b)(2)(O).

The IITA was amended such that for tax years ending on or after December 31, 1995, Subpart F Income is not included in the sales factor.

8. Proration of Deductions-

Nonbusiness income is allocated “together with any item of deductions directly allocable thereto” IITA Section 303(a). Accordingly, if a deduction can be clearly attributed to a particular item of business or nonbusiness income, the deduction should be attributed as such. However, if a deduction can be attributed to both business and nonbusiness income it must be prorated between the different classes involved. The deduction can be prorated in any manner, which fairly distributes it between the classes of income. If a taxpayer modifies the manner of prorating from prior years, disclosure of the nature and extent of the modification should be included on the current year return. If returns or reports filed with all states to which the taxpayer reports are not uniform in the attribution or proration of any deduction, disclosure of the nature and extent of the variance is required. REF: IAC § 100.3010(d)(2)

D. Non-Unitary Partnership Income

IITA § 305 provides for the allocation of partnership income by partnerships and partners other than residents.

- Identify all partnerships.
- Determine whether the partnerships are unitary with the corporate partner.

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- Determine the Illinois income (loss) for each of the non-unitary partnerships.
- Multiply the total Illinois income for each of the non-unitary partnerships by the distributive share of partnership income to be received by the corporate partner.

A partner conducting unitary business with its partnership must include its share of the partnership's business income as business income on its own return. The distributable share of the partnership's business income is not subtracted in Step 4 of the IL-1120 and is governed by IAC § 100.3380(d). This provision applies only if the partnership is not substantially wholly owned by members of its unitary business group. A partnership that is substantially wholly owned by members of its unitary business group must apportion its business income using the separate unitary method, and each partner (unitary or nonunitary) will include in its Illinois net income its share of the business income apportioned to Illinois by the partnership. See the instructions to the Schedule UB.

E. Trust and Estate Income

IITA § 306 indicates that the items of income and deduction that comprise trust and estate income paid or required to be distributed are treated as distributed pro-rata among the beneficiaries. In other words, each beneficiary is deemed to receive his or her share of each item of business income, nonbusiness income, and related deductions, additions, and subtractions.. IITA § 307 states that the beneficiaries of trusts and estates will proportionately include income (business or nonbusiness) earned from trusts and estates in their computation of net income. These items are reported in Step 4 on Lines 25 and 33 of the 2012 Form IL-1120. Auditors should reconcile these amounts to those reported on Schedule NB and Schedules K-1-P or K-1-T.

IV. EXHIBITS

A. Documentation and Support

Some of the information needed to make a determination on the business/nonbusiness income issue can be found in the corporate taxpayer's Annual Report and/or the 10K statements filed with the SEC.

It is very important to specifically identify the source and amount of all income in question. Vague statements such as, "The interest income was from investments of working capital and excess cash" do not adequately identify the source of the income. Auditor's Comments and workpapers are the Department's primary source of information to defend the positions taken in an audit.

The main points to remember are:

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- ✓ Adequately identify each item of income by type, source and amount.
- ✓ Identify the actual trade(s) or business(es) of the recipient.
- ✓ Provide a detailed explanation of the activities surrounding the acquisition, management, and disposition of each source of income.
- ✓ If a unitary relationship is involved between the payor and the recipient of the income, provide detailed information and evidence to support the unitary determination.
- ✓ Follow the rules of documentation and evidence outlined in Chapter 23.

Depending on the type of income involved, the following information should be gathered (if applicable). In all instances the amount of related deductions should also be indicated.

1. Rental Income

- A listing of the specific type of property involved and the amount of rental income received from each type, if not piece, of property.
- A complete description of the property and its location.
- An explanation for the reason for acquisition of the property, its use (prior to being rented) by the company, and the relationship (if any) of the property to the trade or business.

2. Gains Or Losses

- A complete breakdown by individual transaction for each item claimed giving the general description and the amount.
- For the sale of tangible assets, provide a complete description of the property, its use in relation to the operations as a whole, situs at time of sale, date acquired, date sold, sales price and gain or loss on disposition.
- For the sale of intangible assets such as patents, copyrights, stock and interest-bearing securities, the same information should be gathered as discussed in the royalty, dividend and interest section below.
- In the case of a gain/loss from a liquidation, a description of the operations and activities of the subsidiary corporation. If possible, also provide a copy of the plan of liquidation and IRS ruling on the liquidation.
- In the case of foreign currency contracts, a listing of the transactions and an explanation of the purposes for which the taxpayer engaged in this activity.

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3. Interest

- A breakdown by major category showing the source and amount of income from:
  - Government, state, municipal, etc. obligations
  - Loans to subsidiaries
  - Customers notes, trade receivables
  - Bank certificates, accounts
  - Commercial paper
  - Employee notes
  - Supplier notes
  - Other miscellaneous sources.

- A complete description of the activities involved in investing the funds, the type of funds invested, the purpose for the investments (excess cash, portfolio, expansion, business reserves, etc.), the length of the investments (short or long term in nature), etc.

- In the case of loans to subsidiaries or affiliates, describe the relationship between the companies (Does a unitary relationship exist? What was the purpose of acquiring the company?).

4. Dividends

- The names and ownership of the companies whose stock is the source of the dividend income.

- The reason for the acquisition and holding of the stock (i.e. to control the company, for an investment portfolio, to provide access to needed raw materials or supplies, as a short-term investment of excess cash, etc.).

5. Royalties

- The names of the payor companies and the amount received from each.

- Copies of the contractual agreements explaining the patent, trademark, licenses and know-how involved.

- Describe the development and utilization of the patents and trademark in the trade or business.

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- Describe the research and development activities of the company.

B. Examples of Business/Nonbusiness Income

1. Unitary Business Relationship Test

TAXPAYER claimed the capital gains and losses realized from the sale of the stock of ABC Company as nonbusiness income. The facts in this case were very similar to the facts in the U.S. Supreme Court case of Allied-Signal v. Director, Division of Taxation. TAXPAYER, through its disregarded entity TAXPAYER FINANCIAL, LLC, owned 9% of the stock of ABC Company. There were intercompany sales from TAXPAYER to ABC since ABC had acquired DEF Company, a competitor, and TAXPAYER had existing supply contracts with DEF Company. All transactions between TAXPAYER and ABC Company (formerly DEF Company) were at market prices.

There were no intercompany loans, loan guarantees, or common trademarks/trade names between TAXPAYER and ABC. TAXPAYER received no royalty income, interest income, rental income, service income, etc. from ABC. There was one common director in earlier years since the chairman of TAXPAYER was also a director of ABC. There were no common directors and officers between TAXPAYER and ABC during the audit period. Since the facts of this case were similar to Allied-Signal, the capital gains and losses were allowed as nonbusiness income since the transaction did not meet the Unitary Business Relationship Test in that no unitary relationship existed between the two companies.

As far as applying the Operational v. Investment Function Test to this case, the U.S. Supreme Court in Allied-Signal, also agreed as follows:

> …the payee and the payor need not be engaged in the same unitary business as a prerequisite to apportionment in all cases. What is required instead is that the capital transaction serves an operational rather than an investment function. To be sure the existence of a unitary relation between the payor and the payee is one means of meeting the constitutional requirement. It remains the case that in order to exclude certain income from the apportionment formula, the company must prove that the income was earned in the course of activities unrelated to those carried out in the taxing State. The existence of a unitary relation between the payee and payor is one justification for apportionment, but not the only one.

In this case, it was determined that the capital transaction served an investment function rather than an operational function and the capital gains and losses were allowed as nonbusiness income.

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2. Operating vs. Investment Function Test

Ohio Corp A classified portfolio interest as nonbusiness income, claiming that under the due process and commerce clauses of the Constitution, Illinois is barred from taxing interest of the Ohio based corporation. The funds are available, but not used, as working capital in its business operations. Ohio Corp A relies on the Home Interiors position that the mere availability of invested funds for day-to-day business operations is insufficient to establish a minimum connection between the taxing state and the taxpayer. Ohio Corp A used the portfolio fund as collateral for a line of credit obtained in its regular trade or business. The portfolio interest would be reclassified as business income based on the discussion below.

In applying the operational vs. investment function test, the "use" of funds is important. In this test, "used" does not mean spent. A taxpayer can "use" funds in several ways without actually spending the money. For example, funds would be considered "used" if they were pledged as collateral. Funds would be considered "used" if the taxpayer has letters of credit requiring it to keep a certain amount of funds. If the long-term bonds issued by the taxpayer required it to maintain a certain level of funds, these funds would be considered "used" in its operations. Funds required to support a corporation's bond rating may be considered "used" in its business. These are a few examples of how funds may be "used" without actually being spent.

Additionally, if a taxpayer does not know it has excess working capital until the end of a period, then technically all of the funds in a particular account are being "used" as working capital. In other words, the funds are there to be "used" and form a part of working capital which is different than the "available" distinction made in the Home Interiors decision. These funds are more than "available" in that they are to be "used" as needed and are actually earmarked for a business purpose. Conversely, an investment or excess cash is always "available" for working capital, but is not actually earmarked for any particular purpose or to be used as working capital.

C. Court Cases Involving Business Income

Throughout the years a number of court cases have been decided which involved the issue of business and nonbusiness income. Some of the larger cases appear below. For a synopsis of the case and the complete case citation, refer to Chapter 37 (new 49). Cases from other states are provided for informational purposes only and should not be cited as precedent for a position taken during the course of an audit.

1. US Supreme Court

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Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980)
Exxon Corp. v. Department of Revenue of Wisconsin, 447 U.S. 207 (1980)
ASARCO Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982)
F.W. Woolworth Co. v. Taxation and Revenue Dept of N. Mexico, 458 U.S. 354 (1982)
Container Corp. of America v. Franchise Tax Board, 463 U.S. 159 (1983)
Allied-Signal, Inc. v. Division of Taxation, New Jersey 504 U.S. 768 (1992)
MeadWestvaco Corp. v. IL Department of Revenue, 128 S. Ct. 1498 (2008)

2. Illinois Supreme Court

Texaco-Cities Service Pipeline Company v. IL Department of Revenue (1998)

3. Appellate Court

National Realty and Investment Co. v. IL Department of Revenue (1986)
Dover Corporation, et al v. IL Department of Revenue (1995)
Kroger Co. v. IL Department of Revenue, (1996)
Automated Data Processing, Inc. (ADP) v. IL Department of Revenue, (2000)
Home Interiors and Gifts, Inc. v. IL Department of Revenue, (2000)
Hercules, Inc. v. IL Department of Revenue, (2001)
Blessing/White, Inc. v. IL Department of Revenue, (2002)
PPG Industries Inc. v. IL Department of Revenue (2002)
American States Insurance Co. v. IL Department of Revenue, (2004)
Shakkour v. IL Department of Revenue, (2006)
National Holdings, Inc. v. IL Department of Revenue, (2007)

4. Functional Test

Sperry & Hutchinson Co. v. Oregon Department of Revenue (1974)
Appeal of Borden, Inc. California SBE (1977)
Kroger Co. v. Kentucky Department of Revenue (1977)
Arkansas Department of Finance and Administration v. Montgomery Ward & Co. (1979)
Atlantic Richfield Company v. The State of Colorado (1979)
Appeal of Standard Oil of California, California SBE (1983)
American Home Products Corp v. Ohio Tax Commissioner (1990)
Laurel Pipeline Company v. Commonwealth of Pennsylvania (1994)
Texaco-Cities Service Pipeline Co. v. IL Department of Revenue (1998)
Hoechst Celanese Corp v. Franchise Tax Board (California) (2001)

5. Unities Test

ASARCO Inc. v. Montana Department of Revenue, (1982)

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6. Transactional Test

Phillips Petroleum Company v. Iowa Department of Revenue and Finance (1993)
Kimberly Clark Corporation and Kimberly-Clark Worldwide, Inc. v. Alabama Department of Revenue (2012)

D. Hercules Inc. v. Illinois Department of Revenue (2001)

Hercules sold all of its stock in Himont, Inc, a 38% owned corporation that Hercules had formed in a joint venture with an Italian company to produce polypropylene. The court ruled that the stock was an investment and served no operational function even though Hercules purchased 80% of the products that Himont produced. The gain was nonbusiness income.

The following factors might be considered when a taxpayer has structured a disposition of assets or a business similar to the facts occurring in *Hercules*.

1. Identify the asset before and after the transaction forming the new entity.

2. How did taxpayer treat the income and expenses relating to the asset when it was part of the taxpayer's business?

3. How do annual reports, 10-Ks, board of directors meeting minutes, documents relating to the transaction itself, or other public information describe this portion of the taxpayer's assets or business prior to, during, or after its disposition?

4. Determine if the taxpayer engaged in similar transactions divesting other assets or businesses over the past ten to twenty years.

5. Determine if the taxpayer owns more than 50% of the newly formed entity. If so, do a unitary analysis to see if other unitary factors are present between the taxpayer and newly formed entity.

6. Acquisition: Obtain contracts, any binding agreements or similar documents between the taxpayer and the other entity involved in the transaction.
   * What benefits did the taxpayer receive from disposing of its assets or business into the newly formed entity?

7. Management: Look at the newly formed entity to determine how it was managed and operated:

   a) Were there inter-company transactions between the taxpayer and the newly formed entity?
   b) For any employees/officers who resigned their positions with the taxpayer and

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took positions with the newly formed entity, did the taxpayer continue to pay any benefits to these employees/officers?

c) Did these employees/officers of the newly formed entity retain any of their seniority/benefits they had with the taxpayer?
d) Did the taxpayer actually purchase what was now being produced by the newly formed entity? Did the taxpayer actually purchase that product from any unrelated entity?
e) Note the market conditions for that product, in the case of Hercules there was no shortage of supply.
f) Did taxpayer provide services to the new entity? If so, what was the cost of those services? Did the new entity ever actually purchase the same services from an unrelated party? If so, what was the cost of those services?

8. Disposition: Review contracts, binding agreements, and similar documents detailing the form of the disposition of the asset.

   a) How and why was the disposition structured in that manner?
   b) What were the benefits to the taxpayer as a result of the disposition?
   c) Who determined when the disposition should occur?
   d) What did taxpayer do with the proceeds?

9. Did taxpayer use the newly formed entity as a depository for working capital or use it to supply a particular need for taxpayer's business?

10. Identify taxpayer's Illinois business activities to show a relationship between the gain and the taxpayer's Illinois business activities.

11. Obtain copies of returns, audit reports, administrative decisions, etc. from other states and the IRS to determine how the taxpayer:

    a) Treated income and expenses from the asset giving rise to the gain while owned by taxpayer.
    b) Treated the gain upon disposition of the asset.

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APPORTIONMENT

REVISED 8/2014

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I. PURPOSE OF CHAPTER

The purpose of this chapter is to provide the auditor with the information necessary to determine the correct apportionment of business income according to the provisions of IITA § 304. Within the framework of the Due Process and Commerce Clauses and multi-state, multi-national corporate entities, Illinois relies upon the apportionment of business income and allocation of nonbusiness income to determine the fair and equitable amount of tax to be paid. This chapter concentrates on the apportionment provisions provided for under the Illinois Income Tax Act Section 304(a).

Note: To aid referencing, hyperlinks are used within the body of the chapter to link to referenced exhibits and text.

II. REFERENCE SOURCES

A. ILLINOIS INCOME TAX ACT (IITA) SECTIONS

Sec. 304 Business Income Of Persons Other Than Residents
304(a) General
304(b) Insurance companies.
304(c) Financial organizations.
304(d) Transportation services
304(e) Combined apportionment
304(f) Alternative allocation.

B. ILLINOIS ADMINISTRATIVE CODE (IAC)

SUBPART L: BUSINESS INCOME OF PERSONS OTHER THAN RESIDENTS
Section
100.3300 Allocation and Apportionment of Base Income (IITA Section 304)
100.3310 Business Income of Persons Other Than Residents (IITA Section 304) − In General
100.3330 Business Income of Persons Other Than Residents (IITA Section 304) − Allocation
100.3340 Business Income of Persons Other Than Residents (IITA Section 304)
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100.3371 Sales Factor for Telecommunications Services
100.3373 Sales Factor for Publishing
100.3380 Special Rules (IITA Section 304)
100.3390 Petitions for Alternative Allocation or Apportionment (IITA Section 304(f))
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C. COURT CASES

Refer to chapter 37 (49new) for synopsis of the cases:
Appeal of Finnigan Corp., CAL SBE 8/25/88
Appeal of Joyce, Inc., CAL SBE 11/23/66
Dover Corp. v. IDOR 648 N.E.2d 1089 (1995)
GTE Automatic Electric v Allphin (1977)
Beatrice Companies v. IDOR, No. 1-96-1070, Appellate Ct of IL, First Dist, Sixth Div 292 Ill. App. 3d 532; 685 N.E.2d 958; (1997)
Morton International, Inc. v. Glen Bower, Illinois Circuit Court, Docket 01 L 50752, July 8, 2004,
Exelon vs the Department of Revenue, 234 Ill 2d 266 (2009).
PPG, Inc. Docket No. 1-99-2487, Appellate Court of Illinois, First District 262 Ill Dec 208, 765 NE2d 34(2nd Division) Issued: 01/29/2002

III. GENERAL INFORMATION

A. APPORTIONMENT OF INCOME

Once the correct amount of business income (as defined under IITA § 1501(a)(1)) has been determined, the next step is to apportion this business income in accordance with the provisions of IITA § 304. Special apportionment rules apply to business income of Insurance Companies, Financial Organizations (as defined under IITA §1501(a)(8)), and Transportation Companies. These rules are referenced under IITA § 304(b), 304(c), and 304(d) respectively.

- Insurance Companies are discussed in the Audit Manual Chapter 42, (new 31). Guidance for the apportionment of Insurance companies may be found in IAC § 100.3420

- Financial Organizations are discussed in the Audit Manual Chapter 41 (new 30). Guidance may be found in IAC § 100.3405 (taxable years ending on or after December 31, 2008). For the taxable years ending prior to December 31, 2008 the rules are found in IAC § 100.3400. A detailed definition of a Financial Organization may be found in IAC § 100.9710.

- Transportation Companies are discussed in the audit manual Chapter 43, (new 32).

Prior to 12/31/1998 Illinois used a three factor apportionment formula consisting of property, payroll and sales factors. Illinois phased out the property and payroll portion of

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the apportionment formula during the tax years ending on or after 12/31/1998 and 12/31/1999 leaving only the sales factor for years ending on or after 12/31/2000. Information regarding the apportionment formula prior to the years ending 12/31/2000 is located in the exhibits and historical extracts section at the end of the chapter.

Note: While Illinois uses only the sales factor for years ending on or after12/31/2000 the terminology "three factor" and "single factor" is still used by the Department to describe the treatment of apportionment under IITA § 304 Companies meeting the criteria to apportion under IITA § 304(a) are still referred to as three factor companies whereas the term single factor filers is used in referencing insurance companies (IITA § 304(b)), financial organizations (IITA §304(c)), and transportation companies (IITA § 304(d)).

1. DIFFERENCES IN COMPUTING THE APPORTIONMENT

Depending on the structure of a taxpayer's business enterprise and certain filing elections made by the taxpayer, several different methods of computing the apportionment formula may result.

a) Separate Company Basis

Businesses would file an IL-1120 using the separate company formula method in the following situations:

- An unaffiliated taxpayer (i.e. a business having no subsidiaries) operating in numerous states
- A subsidiary company is determined not to be a member of a unitary business group.

EXAMPLE 1

Company A, an unaffiliated corporation, has manufacturing and sales operations in Illinois, Indiana, California, and Florida for the tax year ended December 31, 2010. Company A would file an IL-1120 whereby a portion of the income is assigned to Illinois based on the business activity in Illinois (as reflected by the Illinois percentages of sales).

EXAMPLE 2

Corporations B, C, D, and E are affiliated corporations who file a Federal consolidated 1120 for the tax year ended December 31, 2010. Corporations B, C, D, and E all have operations in Illinois, Texas, and California. After a unitary determination is performed it is determined that companies C, D, and E form a unitary business group for Illinois purposes. Company B is

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determined not to be a member of the unitary business group. Company B would file an IL-1120 whereby a portion of the income would be assigned to Illinois based on the business activity in Illinois (as reflected by the Illinois percentages of sales).

In both examples the separate company filer would apportion business income based on the sales factor using only its own business's data in computing the numerators (Illinois figures) and denominators (Everywhere figures) of each factor.

b) Separate Unitary Basis

IAC §100.5201(i) provides that non corporate taxpayers and S corporations that are members of a unitary business group are not eligible to file as a combined member with corporations or in combination with other non corporate taxpayers or S corporations. Some partnerships and all S corporations that are members of a unitary group must file separate unitary returns using Schedule UB. Specific instructions for filing may be found in the Schedule UB Instructions for both. In a separate unitary filing, the taxpayer apportions the combined business income of the unitary group to Illinois using its separate-company Illinois numerators for each factor and the combined everywhere denominators of the members of the group.

c) Combined Unitary Basis

Under the combined unitary basis, the numerator of each of the apportionment factors would be made up of all applicable Illinois activity of all members required to file an IL-1120 which are included in the combined return election. The denominator of each factor would be made up of all applicable activity of all members (i.e. those required to file IL-1120's as well as those not required to file Illinois returns and those not included in the combined return election.) Dividing the Illinois activity of all of the combined return members by the unitary business group's everywhere activity would result in the combined return apportionment factors.

C corporations are the only UBG members required to file combined returns. Individuals, S corporations, partnerships, trusts and estates may not file combined returns. Since 1987, members of a combined group may have different taxable years. See IAC § 100.5265 Common Taxable Year. If a unitary business group includes both C corporations and one or more other entities, the C corporations must file a combined return that includes the Illinois numerators of the C corporations' factors and the combined

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business income and everywhere denominators of all members of the group, and the other members must file separate unitary returns.

Example
Companies B, C, D, and E are affiliated corporations who file a federal consolidated return for taxable year ending December 31, 2010. Corporations B, C and D all have operations in Illinois, California, and Texas. E has operations in Texas and California. A unitary determination revealed a unitary relationship exists between all four corporations. Corporations B, C, and D file a combined return.

When filing the combined return, B, C, and D compute the group's combined sales factors. In determining these factors, B, C, and D's combined Illinois sales (the numerators) are divided by the total sales everywhere (the denominators) of the unitary business group (i.e. Corporations B, C, D, and E). The results would appear on one IL-1120.

For more information regarding part-year members of a unitary group, refer to the (Computation of The Corporate Tax Liabilities) section.

d) Partnership Percentages in the Factors

When the activities of a partner (or the activities of a unitary business group including the partner) and the activities of a partnership, constitute a unitary business relationship, then the partner's share of the partnership's business income and factors shall be combined with the business income and factors of the partner or with the combined business income and factors of the unitary business group, including the partner, as the case may be.

The partner will include its percentage share of the partnership's sales (everywhere and Illinois) with its own sales (everywhere and Illinois). The partner's share of the factors should be determined using the percentage of profits to each partner per the partnership agreement. This treatment would be consistent with the inclusion of the same percentage (of profit) in the unitary business group's income. IAC § 100.3380(d)(4).

When substantially all (more than 90%) of the interests in a unitary partnership are owned by partners who are members of the unitary group, (determined without regard to the 80-20 rule and the noncombination rule), the flow-up rule in IAC § 100.3380(d) does not apply. Instead, the partnership and the partners must file separate unitary returns. This rule must be followed for tax years beginning on or after June 30, 2008 (the effective date of the amendment adopting IAC § 100.3380(d)(4)). For prior years, taxpayers may petition to use this rule. See IAC § 100.3380(a)(2).

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For more information regarding partnership income, refer to the Partnership Chapter 28.

e) Intercompany Eliminations

Elimination of income and deduction items arising from transactions between members of the group must be done whenever necessary to avoid distortion of the group's income, the denominators used by all members of the group in calculating apportionment factors, or the numerators used by any particular member of the group in calculating its apportionment factors. REF: IAC § 100.5270(b)(1).

Note: IAC §100.5270(b)(1) is only for intercompany eliminations of income and federal deductions. Factor intercompany eliminations are made under:

- Sales factor (Three-factor): IAC § 100.3370(a)(2)(D)(ii)
- Sales between a partner and partnership: IAC § 100.3380(d)(2)(A)

Two of the most common areas of intercompany transactions, which affect the apportionment formula, involve sales and rents. Sales between members of a unitary business group filing a combined return must be eliminated. The sales should be eliminated from the company originating the sale. By doing this, the applicable amount of sales to the final non-related party would be reflected in the factor of the member making such sale outside the group.

Management fees paid by subsidiaries to their parents would be another example of potential intercompany eliminations, which can affect the sales factor computation.

2. IITA SECTION 304(f) ALTERNATIVE ALLOCATION OR APPORTIONMENT

In the event that IITA § 304(a) through (e) and (h) do not fairly represent the extent of a person's business activity in Illinois there are the provisions found within IITA § 304(f) to offer a more fair representation. Under 304(f) the taxpayer may petition for, or the Director may require:

- separate accounting
- exclusion of any one or more factors
- inclusion of one or more factors, or;

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- another method to ensure a fair and equitable allocation and apportionment of the persons income.

An IITA Section 304(f) petition for alternative apportionment or adjustment is often referred to as a "304(f) petition" or "304(f) adjustment". Further guidance for § 304(f) adjustments can be found in IAC § 100.3380 which reiterates the above and details the determination by the Director. Only the Director has the authority to grant an alternative apportionment method. The outline for making a 304(f) petition is listed in IAC § 100.3390.

The petition must be clearly labeled "Petition for Alternative Allocation or Apportionment" The petitioner must include supporting facts and information to meet the burden of proof under IAC § 100.3390 (c). If the petitions sole basis for alternative apportionment is a different percentage, it will be rejected. The petition must be sent to:

Illinois Department of Revenue
Legal Services Bureau/Income Tax
101 W. Jefferson St
Springfield, IL 62797-9001

IAC § 100.3390(e) gives guidance on the timing for filing situations regarding the IITA § 304(f) petitions. For an original return, the petition to file for an alternative apportionment method must be requested in writing 120 days prior to the due date of the return (including extensions). If the taxpayer does not allow the 120 day period for approval they must file and pay tax according to the statutorily approved method of allocation or apportionment.

A 304(f) petition may be filed as an attachment to a return amending the original return (which used the statutory apportionment methods). A taxpayer whose petition was originally rejected may also file an amended return with an attached 304(f) petition.

If a notice of deficiency ("NOD') is issued as the result of an audit, a 304(f) petition may be filed as related to the audit adjustments. However, if the NOD is not the result of an audit and the taxpayer failed to petition for a 304(f) adjustment through an original or amended return, no petition may be filed with the protest.

IAC § 100.3390(f) lists three potential outcomes in the consideration of a petition. The Director will issue a letter ruling advising the taxpayer whether the petition has been determined to be one of the following:

- **Acceptance** of the alternative apportionment formula.

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- **Partially accepted** – the Director has established that relief is warranted, but disagrees with the proposed method. The taxpayer can then submit a modified formula or protest the Director's rejection and request an administrative hearing

- **Rejected** -the petition is entirely rejected, the Director will state the reasons for the rejection.

If the taxpayer has filed the petition according to the procedures, a denial is not the final administrative decision. The denial may be protested in administrative hearing on appeal. A detailed discussion to the appeal process, bifurcated administrative hearings, and the Directors decision can be found in IAC §100.3900 (g)-(i).

B. ALLOCATION OF INCOME

Once taxable income has been adjusted by the addition and subtraction modifications, the proper allocation of the income must be made to determine the proper Illinois tax liability. Unless the company's base income is derived solely from Illinois (in which case 100% of its base income is taxable in Illinois) or the special allocation rules of IITA § 304(f) are in effect, this sourcing of income is accomplished either by using the allocation rules provided in IITA § 301(c) and § 303 or the apportionment rules provided in IITA § 304. In addition, income from:

1. Except in the case of a unitary partner subject to IAC § 100.3380(d), a partner allocates or apportions income passed through from partnerships in accordance with IITA § 305,

   Note: Refer to the partnership income section of Chapter 22, (28 new) for the proper treatment of unitary and nonunitary partnership income.

2. Beneficiaries allocate or apportion income passed through from estates and trusts in accordance with IITA § 306 and § 307.

Refer to Chapter 34, (28 new) for a discussion of S-Corp, Partnerships, 1040-T&E, Composite, PTE Returns and audit procedures.

Section 303 governs the allocation of nonbusiness income. The section has remained essentially the same (with the exception of the reference to the Illinois Lottery Law and the specification that the rules relate to nonresidents only) since the inception of the IITA in 1969. In subsection (a) it states that:

- any item of capital gain or loss

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- income from rents or royalties from real or tangible personal property
- interest
- dividends
- patent or copyright royalties
- Illinois Lottery prizes awarded and proceeds from sales of rights to receive prizes
- Unemployment benefits
- (minus related deductions)

To the extent such item constitutes nonbusiness income along with any related deductions shall be allocated by non residents.

The remainder of the section deals with the allocation rules of various types of nonbusiness income. Before these rules can be put into effect however, income must first be determined to be business or nonbusiness in nature.

The (Illinois Allocable Income) section discusses the allocation rules for nonbusiness income.

The (Apportionment of Income) section deals with apportionable income and the computation of the apportionment formula.

IV. APE SPECIFIC LAW APPLICATION

A. SALES FACTOR

IITA § 304(a)(3) and IAC §100.3370, § 100.3371 and § 100.3380(c) govern the sales factor. In general, the sales factor used to apportion business income is expressed as a fraction. The numerator is the total sales of a person in this State during the taxable year, and the denominator of the fraction is the total sales of the person everywhere during the taxable year.

1. SALES OF TANGIBLE PERSONAL PROPERTY – DENOMINATOR

IITA Section 1501(a)(21) defines "sales" as the gross receipts of a taxpayer not allocated under Sections 301, 302, and 303. For this reason, the sales factor can include all receipts, which are generated in the regular course of the taxpayer's trade or business. Receipts of a nonbusiness nature are never included in the sales factor.

The first step in determining what constitutes "sales" for purposes of the denominator of the sales factor for any specific taxpayer is to identify the taxpayer's trade or business. In the audit situation, this has already been

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established during the formation of a unitary group or in the nonbusiness income examination. It is important to remember that a person may be involved in more than one trade or business. IAC § 100.3370(a) provides examples of what would constitute "sales" for taxpayers in various trades or businesses. These examples are paraphrased below.

a) Receipts Included In the Sales Factor

1. A person selling goods or products should include all gross receipts from the sales of such goods or products (including other property, which could be included in the inventory of such person). Gross receipts for this purpose means gross sales less returns and allowances but including:

    - Interest income.
    - Service charges.
    - Carrying charges.
    - Time-price differential charges which are attendant to such sales.
    - Federal and state excise taxes (including sales taxes) are included if the taxes are passed on to the buyer or included as part of the selling price of the product.

2. A person involved in cost plus fixed fee contracts should include the entire reimbursement cost, including the fee.

3. A person engaged in providing services should include the gross receipts from the performance of such services including fees, commissions and similar items.

4. A person engaged in renting real or tangible property should include the gross receipts from the rental, lease or licensing of the use of such property.

5. A person engaged in the sale, assignment or licensing of intangible personal property such as patents or copyrights should include the gross receipts from such sale, assignment or licensing.

6. A person who sells tangible property (including real estate) and equipment used in the business should include the gross receipts from such sales, unless the sale is excluded as an occasional sale under IAC § 100.3380(c)(2). See the Special Rules section below.

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b) Receipts Excluded From the Sales Factor

- Occasional sales of assets (tangible or intangible) Ref: IAC § 100.3380(c)(2)
- Gross receipts that are excluded or deducted in the computation of federal taxable income or federal adjusted gross income that are not added back in the computation of Illinois base income. This includes the Extraterritorial Income Exclusion on federal Form 8873. See discussion in Exhibit and Historical Extracts section at the end of the chapter. Ref: IAC § 100.3370(a)(2)(B)
- Intercompany sales between members of a unitary business group. Ref: IAC § 100.5270(b)(1)

c) Occasional Sales of Assets

Gross receipts arising from incidental or occasional sales of assets used in the regular course of a taxpayer's trade or business are **entirely excluded** from the sales factor. IAC § 100.3380(c)(2)). This can include the sale of an entire division or product line since its inclusion in the sales factor would also materially affect the amount of income apportioned to Illinois (IAC § 100.3380(c)(2)). This regulation can also apply to a large, one-time sale of business intangibles such as stock or goodwill.

The key in determining whether or not this special rule applies is to determine if the receipts from asset sales are derived from the regular or routine disposition of assets. For example, if a large manufacturing concern owns its own fleet of delivery trucks, and replaces them on a regular replacement program, then the receipts were derived from the regular or routine disposition of assets. These receipts are included in the sales factor.

If, however, the manufacturing concern decided to make its business smaller and more economical by making a onetime reduction of 50% of its truck fleet, the receipts generated from this transaction would be excluded from the sales factor if the amounts were extraordinary. In this situation, a 50% truck disposition would not be considered regular or routine, and the inclusion in the sales factor of the gross receipts from the sale of those trucks could distort the factor.

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Example
A major oil company sells an entire operating division that manufacturers special packaging products for the food industry for $1.3 Billion. Of this amount $900 Million is for real and tangible assets, $400 Million is from intangible assets including goodwill. The entire $1.3 Billion in proceeds is excluded from the sales factor under IAC § 100.3380(c)(2).

Note: IAC § 100.3380(c) specifically refers to the sales factor in IITA § 304(a)(3). Therefore it would not apply to other subsections in Section 304 such as 304(c) which is financial organizations.

d) Intercompany Sales-Eliminations

Elimination of income and deduction items arising from transactions between members of the group must be done whenever necessary to avoid distortion of the group's income, the denominators used by all members of the group in calculating apportionment factors, or the numerators used by any particular member of the group in calculating its apportionment factors. REF: IAC § 100.5270(b)(1).

In addition, IAC § 100.3370(a)(2)(D)(ii) states under receipts that are excluded from the sales factor that the gross receipts from intercompany transactions between two corporate members of a federal consolidated group, which income is deferred under Treas. Reg. § 1.1502-13 will be included in the sales factor of the recipient, unless;

- these are subtracted under a provision of IITA § 203, or;
- eliminated in combination of the two corporations as members of a unitary business group.

Intercompany sales are not included in the sales factor because the federal taxable income from the transaction is deferred until such time as the receipts leave the group. Two of the most common areas of intercompany transactions, which affect the apportionment formula, involve sales and rents. Sales between members of a unitary business group filing a combined return must be eliminated. The sales should be eliminated from the company originating the sale. By doing this, the applicable amount of

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sales to the final non-related party would be reflected in the factor of the member making such sale outside the group.

Management fees paid by subsidiaries to their parents would be another example of potential intercompany eliminations, which can affect the sales factor computation.

Sales eliminations between a partner and partnership are under IAC § 100.3380(d)(2)(A). This was amended effective for tax years beginning on or after June 30, 2008 (calendar year 2009). Under this section:

- The partner's distributive share of the business income, and apportionment factors of the partnership shall be included in the partners business income and apportionment factors.
- The partnership's income will be determined by including transactions between the unitary partner, or members of its unitary business group and the partnership.
- All transactions between the unitary business group and the partnership shall be eliminated for purposes of computing the apportionment factors of the partner and of any other member of the unitary business group.

EXAMPLE

Partner and Partnership are engaged in a unitary business. Partner owns a 20% Interest in Partnership. Partnership has $10,000,000 in sales everywhere $3,000,000 of which is to the Partner. Illinois sales are $4,000,000 of which $1,000,000 are to Partner. In computing its apportionment factor, Partner will include $1,400,000 from Partnership in its everywhere sales ((10,000,000 – 3,000,000) x 20%) and $600,000 from Partnership in its Illinois sales (($4,000,000 – 1,000,000) x 20%).

EXAMPLE

Partner owns 50% of a unitary partnership. Partner makes $1,000,000 in sales to the partnership which would be included in Partner's IL-1120 sales factor. Since 100% of the sales made to the unitary partnership are included in sales on the IL-1120, 100% of the sales are eliminated and not 50%.

Under IAC § 100.3380(d), sales eliminations are allowed on any intercompany sales that would be included in the sales numerator or

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denominator of a unitary filer. Prior to tax years ending June 30, 2008 there were no sales eliminations between a unitary partner and a partnership, or vice versa. If the partner did eliminate intercompany sales between the partnership and unitary partner prior to the effective date, then that elimination will be allowed for all years. If the taxpayer did not eliminate sales, but now wants to apply the revised regulation retroactively, then the taxpayer must give the auditor an amended return and petition for alternative apportionment under IITA § 304(f).

Once the proper amount of sales has been determined for purposes of the denominator of the sales factor, the sales must then be allocated to the appropriate state for purposes of the numerator of the sales factor. IAC § 100.3370(c) provides the general allocation rules. The following discussion is based primarily on that regulatory section.

e) EXTRATERRITORIAL INCOME EXCLUSION (See Exhibit and Historical Extracts Section)

2. SALES OF TANGIBLE PERSONAL PROPERTY IN ILLINOIS

The allocation of sales of tangible personal property (other than to the U.S. government) is governed by IITA § 304(a)(3)(B). These sales are in Illinois if:

- The property is delivered or shipped to a purchaser within Illinois regardless of the F.O.B. point or other conditions of the sale and the seller is taxable in Illinois
  (the destination rule), OR

- The property is shipped from an office, store, warehouse, factory, or other place of storage in Illinois and the seller is not taxable in the state of the purchaser (the throwback rule).

a) The Destination Rule

The first part of the above allocation rule is known as the destination rule. Property delivered or shipped to a purchaser within Illinois is assigned to Illinois, even though the property is ordered from without this state. Property is delivered or shipped to a purchaser within Illinois if the shipment terminates here, even though the property is later transferred by the purchaser to another state.

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Note: See Section below on Dock Sales.

The term "purchaser within Illinois" includes the ultimate recipient of the property if the seller, at the designation of the purchaser delivers or ships the property directly to the ultimate recipient, a customer of the purchaser, in Illinois [i.e. third-party drop shipment].

When the property being shipped by a seller to a purchaser in another state is diverted, while en route, to a recipient in Illinois, the sale is in Illinois.

An exception to the destination rule is in effect for sales to the United States Government. These sales are allocated to Illinois if the property is shipped from an office, store, warehouse, factory, or other place of storage in Illinois to the U.S. Government within or without Illinois. Only sales for which the U.S. Government makes direct payment to the seller pursuant to the terms of its contract constitute sales to the U.S. Government. Thus, as a general rule, sales by subcontractors to a prime contractor (the prime contractor being the party of the contract with the U.S. Government) do not constitute sales to the U.S. Government. REF: IAC § 100.3370(c)(2).

The destination rule may be illustrated by the following examples:

Example 1
"A" with inventory in Iowa sells $100,000 of its products to a purchaser having branch stores in several states including Illinois. The order for the purchase is placed by the purchaser's central purchasing department located in New York. $25,000 of the purchase is shipped directly by rail car to the purchaser's branch store in Illinois. The balance of the purchase ($75,000) is shipped directly to the purchaser's branch stores in other states. The branch store in Illinois is the "purchaser within Illinois" with respect to $25,000 of the $100,000 sale.

Example 2
The facts remain the same as in Example 1 except that the purchaser maintains a central warehouse in Illinois, which receives all merchandise purchased for branch stores located in the Midwest. The entire $100,000 order is shipped to this Illinois warehouse from which the purchaser reships $75,000 of the goods to branch stores in other states. The entire $100,000 sale is in Illinois.

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Example 3
"B" sells merchandise to a purchaser in Indiana. Pursuant to the purchaser's instructions, "B" ships the merchandise directly to the purchaser's customer in Illinois. The sale by "B" is in Illinois.

Example 4
"C", a produce grower in California, begins shipment of perishable produce to a purchaser in New York. Due to delay in shipment, it becomes necessary for the purchaser to divert the shipment to its produce warehouse in Illinois. The sale is in Illinois.

Example 5
"E" contracts with the General Services Administration to deliver a number of trucks, which are paid for by the U.S. Government. The sale is an Illinois sale only if the trucks are purchased from a place of storage in Illinois since the government directly paid for the trucks.

Example 6
"F" contracts with the National Aeronautics and Space Administration to build a rocket.
"G", a subcontractor builds a component of the rocket and delivers the component to "F" in Florida. The component is shipped from Illinois. The sale is not a sale to the U.S. Government even though the component becomes part of a rocket paid for by the government. Thus, whether the sale is an Illinois sale or a Florida sale depends on whether "G" is taxable in Florida (i.e. The Throwback Rule).

b) Dock Sales

“Dock sales” are transactions in which an out-of-state purchaser picks up the seller's products at the seller's shipping dock for delivery to the purchaser's location outside the state. Either the customer picks up the products in their own vehicles, or contracts for delivery by common carrier. In these cases the sales are consummated when the goods are picked up at the seller's dock.

IITA § 304(a)(3)(B)(i) provides that sales of tangible personal property are in Illinois if the property is delivered or shipped to a purchaser, other than

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the U.S. government, within this State, regardless of the f.o.b. point or other conditions of sale. Ref IAC § 100.3370(c)(1).
Therefore, even though a taxpayer's customer may receive physical possession of the property outside Illinois, a sale may nonetheless constitute an Illinois sale where the destination of the property sold is Illinois. Ref: IT 03-0034-GIL

Example
ABC manufactures various products, consisting of tangible personal property. ABC manufactures its products in six states, including California, Georgia, North Carolina, Ohio, Texas, and Wisconsin. ABC's products are shipped from its manufacturing facilities in these states to unaffiliated, third party distributors located in Illinois and other states. There are three methods of shipment or delivery of the products to the distributor's Illinois facilities:

1. The Illinois distributor picks-up the products from the ABC manufacturing facility in one of the six states and transports the products in the distributor's vehicles to the distributor's Illinois facilities.

2. The Illinois distributor arranges with common or contract carriers to pick-up the products from the ABC manufacturing facility in one of the six states and deliver the products to the distributor's Illinois facilities.

3. ABC arranges with common or contract carriers for shipment of the products to the distributor's Illinois facilities.

In all three cases above the sale should be allocated to Illinois, provided that ABC has nexus with Illinois.

Even if 100% of the sales of tangible, personal property have been allocated by the taxpayer to some state, the auditor **must verify** the taxpayer's apportionment workpapers as to the Illinois destination amount. The auditor will need to question the taxpayer's method of accounting for dock sales, especially in cases where the cost of delivery of the goods may be substantial. The taxpayer could easily be confused as to which state the sale should be allocated to if the purchaser contracts for delivery.

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The auditor may want to spot-check some sales invoices or purchase orders to check for customer pickups, and then trace those sales to the sales journal. If the taxpayer is not accounting for dock sales properly, and it is impossible to determine from examination of the taxpayer's sales ledgers what the correct amount of Illinois sales are, then the auditor will need to contact CAA to determine an appropriate method of test checking the taxpayer's sales.

Note: If customer pickups are occurring but are undocumented these may be referred to the sales tax audit area for further review of any sales taxes owed.

c) The Throwback Rule

The second part of the allocation rule of IITA § 304(a)(3)(B) is known as the throwback rule. A sale of tangible personal property is assigned to Illinois if the merchandise is shipped from any place of storage in Illinois, and the seller is not taxable in the state of destination. The length of time that merchandise is stored in Illinois is irrelevant when determining whether or not a sale should be "thrown back" to Illinois. Even "temporary" storage would constitute the point of origin for a sale. REF: Sunshine Letter IT93-0152.

Throwbacks apply only to sales of tangible personal property. There are no throwbacks for sales of services.

Note: However, IITA § 304(a)(3)(C-5)(iv) does contain a "throw out" provision for the sales of service which is discussed later in the sales of service section.

IITA § 304(a)(3)(B) states that sales of tangible personal property are in this State if:

- it is shipped from an office, store, warehouse, factory or other place of storage in this State and either of the following:
- it is purchased by the United States Government; or
- the person is not taxable in the state of the purchaser (and shipped from this State)

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(1) Taxability in Other State

IITA § 303(f)(1)/ IAC § 100.3200(a)(1)(A)

IITA § 303(f) determines the "taxability in another state" for purposes of allocating nonbusiness income. IAC § 100.3200 adopts the principles of this statute for purposes of the throwback rule. It states that a taxpayer is taxable in another state (including a foreign country) if:

- IAC § 100.3200(a)(1)(A) In that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or

- IAC §100.3200(a)(1)(B) That state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

(a) Franchise Tax and Corporate Stock Tax

The taxpayer can avoid sales throwback to a particular state if subject to one of the taxes in IAC § 100.3200(a)(1)(A) including:

- a franchise tax measured by net income,
- a franchise tax for the privilege of doing business, and
- a corporate stock tax.

IAC § 100.3200(a)(2) states that the taxpayer has to be "subject to such tax by reason of income-producing activities" in that state or country. Although nexus under P.L. 86-272 is not required in order to be subject to a franchise tax or a corporate stock tax, nevertheless the taxpayer has to have some business activities in the state (or foreign country) in order to be subject to the franchise tax or corporate stock tax.

Consequently, a corporation which pays a minimum franchise tax in order to qualify for the privilege of doing business in a state is not considered to be taxable in that state if the minimum tax bears no relation to the corporation's activities with such state. However, if the franchise tax is anything more than a "minimum"

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tax, a taxpayer who is subject to the tax and pays it would be considered to be taxable in that state.

A taxpayer that claims to be taxable in a state based on the IITA § 303(f)(1)/ IAC § 100.3200(a)(1)(A) requirements must establish not only that under the laws of that state the taxpayer is subject to one of the specified taxes, but also that the tax is PAID. If the taxpayer is subject to the tax but does not, in fact, pay it, the taxpayer is not considered to be "taxable in the other state." If, on the other hand, the taxpayer is not subject to any of the taxes in a certain state but establishes that his activities in that state are sufficient to subject to a net income tax if the state had enacted such a tax, the taxpayer is considered taxable in the other state under IITA § 303(f)(2).

Illinois is one of the few states that require a person to not only be subject to a tax based on income in a destination state but also to file a return if that state has imposed such a tax. Most other states' regulations and the MTC model regulation provide that failure to file a return with another state merely creates a presumption that the taxpayer is not taxable in that state. The Illinois rule was upheld in Dover Corp. v. Dept. of Revenue, 271 Ill.App.3d700 (1995).

(2) Examples of Non-Income Taxes Under IITA § 303(f)(1) & IAC § 100.3200(a)(1)(A)

(a) State of Texas

Effective January 1, 2008

Texas franchise tax is a gross income or "margin" component based tax. Taxable "margin" means either 100% of gross receipts, minus either costs of goods sold or employee compensation paid by the taxpayer, or 70% of gross receipts. This new component will not be subject to Public Law 86-272. Consequently, starting in 2008 if the taxpayer is paying any kind of a tax measured by the amount of business activities in Texas, the taxpayer will be taxable in Texas under Section 100.3200.

Between January 1, 1992 and December 31, 2007, Texas imposed a franchise tax on entities doing business in the state. Schedule A of the Texas Franchise Tax return, was a tax on the

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measurement of the taxpayer's capital apportioned by the percentage of gross receipts in Texas. This portion of the tax fell under IAC §100.3200(a)(1)(A), which included the franchise tax and corporate stock tax. Consequently, if the taxpayer reported business activity in the State of Texas and paid more than the minimum tax, the taxpayer would be taxable in Texas.

The second component of the pre-2007 Texas Franchise tax was a tax on "earned surplus," and is an income tax covered by Public Law 86-272.

(b) State of Washington

The State of Washington imposes the State Business and Occupation Tax upon several specific businesses. This tax is calculated upon gross income, and is based upon the proportion of business activity conducted in the state.

Therefore, sales made by taxpayers subject to this tax cannot be thrown back to Illinois, since it meets the requirements of IAC § 100.3200(a)(1)(A).

(3) Tax Based On Net Income

IITA § 303(f)(2)/IAC § 100.3200(a)(1)(B)

Under this provision, a taxpayer is subject to tax by a state even if it does not file a return or pay any tax to that state if the other state could impose an income tax on the taxpayer, but does not. If the taxpayer claims it is subject to a tax based on net income in a foreign state or country, then it has to have nexus by reason of P.L. 86-272. IAC §100.3200(a)(2)(B) provides the following:

- In the case of any state (with the exception of a foreign political entity), the Constitution, statutes and treaties of the United States are the deciding factors in whether a state has the jurisdiction to levy tax on a taxpayer.

- A state doesn't have jurisdiction to impose a tax if Public Law 86-272 prohibits the states taxing authority. (Additional Reference: IAC § 100.9720 Nexus, and Chapter 36 of Audit Manual, (new 23)

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IAC § 100.3200(a)(2)(C) states that in the case of any foreign country or a political subdivision thereof:

- The determination of whether a state has jurisdiction to subject the taxpayer to a net income tax will be determined as if the foreign country or division of foreign country were a state of the United States or political subdivision of a U.S. state.

- A person who is not required to pay a net income tax by a foreign country as the result of a treaty exempting certain persons or business activities or sources of income is not subject to net income tax in that jurisdiction.

While IAC §100.3200(a)(1)(B) provides that the taxpayer is considered taxable in another state if that state has jurisdiction to tax but does not tax. IAC § 100.3200(a)(2)(D) provides guidance on when that state or country imposes a tax on net income and the person can show a specific provision which exempts the taxpayer
from taxation in that state. A person is not subject to tax in another state or in a foreign country if that state's or country's constitution, statutes or regulations, or a holding of that county or state's courts, exempts that person from taxation even though that person could be subject to a net income tax under the US Constitution, statutes and treaties.

In the event a sale is made by a taxpayer to a state where nexus is established, but returns are not required to be filed, the sale is not subject to reversionary treatment. A destination state, such as Nevada may have the jurisdiction to tax, but because it currently chooses not to exercise the jurisdiction does not provide justification for the state of Illinois to include the sale in the numerator of the Illinois sales factor.

Currently four states do not impose a corporate tax based on net income: Nevada, South Dakota, Washington State, and Wyoming. Ref: Federation of Tax Administrators-January 2013

IAC § 100.9720(f) discusses the application of the Joyce Rule. For more information regarding the Joyce rule, the Finnigan case from California, and the Dover Corporation case, refer to the (Unitary Business Groups) section and audit manual court cases chapter 37 (new 49).

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The following are some examples of the throwback rule:

Example 1
A corporation, although subject to the provisions of the net income tax statute imposed by State X, has never filed income tax returns in that jurisdiction and has never paid income tax to X. For purposes of allocation and apportionment of A's income, A is not considered taxable in State X because it does not meet either of the tests contained in IAC § 100.3200(a).

Example 2
"D" has its headquarters and factory located in Pennsylvania. It maintains a branch office and warehouse in Illinois. Its only activity in Indiana is the solicitation of orders by a resident salesman. All orders by the salesman in Indiana are sent to the branch office in Illinois for approval and are filled by inventory located in Illinois. "D" is not taxable in Indiana because Indiana does not have the jurisdiction to subject "D" to a net income tax by virtue of Public Law 86-272. Therefore all sales of merchandise to purchasers in Indiana from the Illinois warehouse are Illinois sales.

Example 3
Corporation A has a warehouse in Illinois. "A" has no nexus in the state of Michigan. "A" ships $100,000 of merchandise from its Illinois warehouse to a customer located in Michigan. Since "A" is not taxable in Michigan, destination cannot be used as a basis for assigning sales. The $100,000 sale is reverted or "thrown back" to the numerator of the Illinois' sales factor.

Example 4
Company A has taxable locations in Illinois, Indiana, and Nevada. State Income Tax returns are filed in each state except Nevada. Sales to Indiana are not subject to reversionary treatment since A is taxable in Indiana. Nevada does not impose a tax based on net income. Therefore, although no return was filed in Nevada, A is still considered "taxable in Nevada" and sales into that state would not be subject to the throwback rule.

(4) Drop Shipments

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The throwback rule also applies to transactions involving drop shipments. Drop shipments occur when the origin of the shipment is from inventory of taxpayer's supplier that is shipped by the supplier directly to the taxpayer's customer.
The Illinois Supreme Court's decision in GTE Automatic Electric v Allphin (1977) upheld the principle of including single and double throwbacks in the sales factor as it relates to direct and drop shipments, respectively. In that case the Supreme Court found that "drop shipment" sales of tangible personal property shipped by a seller's supplier from the supplier's inventory in Illinois or in a state in which the taxpayer was not taxable to a purchaser in a state in which the seller is not taxable fall squarely within the language of the IITA § 304(a)(3)(B)(ii). REF: Sunshine Letter IT90-0200. See sections on The Double Throwback Rule and The Triple Throwback Rule.

A synopsis of the GTE Automatic Electric case can be found in the old Chapter 37 (new 49).

The following example illustrates how the single throwback rule applies to drop shipments:

Corporation A is located in Illinois. Goods are shipped to A's customer by its supplier. A's customer is located in Michigan but A's supplier, and the supplier's warehouse are both located in Illinois. A is not taxable in Michigan. Under IITA § 304(a)(3)(B)(ii) the sales are included in the Illinois numerator because the taxpayer is not taxable in the state of the purchaser.

This example illustrates the single throwback rule. The "double throwback rule" applies where the supplier's warehouse is not in Illinois or in any state in which the taxpayer is taxable, so that the taxpayer is not taxable in either the origination or the destination state.

d) <u>The Double Throwback Rule</u>

IAC § 100.3380(c)(1) provides for the double throwback rule. A sale of tangible personal property is assigned to Illinois if the sale is made from Illinois and the seller is not taxable either in the state of origin (supplier's place of shipment) or destination (where goods were shipped to taxpayer's customer). This type of transaction is prevalent in drop shipment sales.

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This section of the IAC enables the seller to classify the destination of sales by the purchaser's invoice address, without making it necessary for the seller to examine the facts as to the purchaser's reshipment or trans-shipment of the goods.

A legitimate argument could be raised to use the "ultimate destination" (i.e. ultimate market or destination state). However, this construction would introduce time consuming and burdensome complexities that would require sellers to examine into the course of goods after they are turned over to the purchaser. REF: Sunshine Letter IT88-0247.

The MJK Corporation, an Illinois based toy manufacturer, sold $100,000 of merchandise to the FUN Corporation. MJK did not have the items in stock, so it contacted its supplier, the Party Store to ship the items to FUN. The Party Store shipped the items from its New York warehouse to FUN's California assembly plant. MJK Corporation is not taxable either in California or New York. MJK's sales office is located in Illinois. Because MJK's sales office is located in Illinois, it can be said that the business activity that generated the sale was performed in Illinois. For this reason, the $100,000 sale by MJK would belong in the numerator of its sales factor as an Illinois sale.

Note: The “triple” throwback previously discussed in earlier manuals is only a continuation of the double throwback methodology. In effect there is no “triple” throwback, only double throwback.

e) Joyce Rule

IAC § 100.9720(f) gives the Department’s long-standing position of the Joyce Rule. The determination of nexus must be performed independently for each member of the unitary business group. If a member does not have sufficient contacts with Illinois to establish nexus, then that member cannot have nexus attributed to it because other affiliates in the unitary business group do have nexus. A member of the unitary business group without nexus would have zero Illinois sales for the combined apportionment factor numerator, while it’s everywhere sales would be included in the combined apportionment factor denominator.

f) Foreign Throwback Sales

(1) Sales of Tangible Personal Property for Resale to Foreign Subsidiaries

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Gross receipts are specifically excluded from the sales factor numerator if the buyer is excluded from the same unitary group per the 80/20 rule under IITA § 304(a)(3)(B)(ii). Sales of tangible personal property are not in this State if the seller or purchaser conduct 80% or more of total business activity outside of the United States, and the property is purchased for resale.

Therefore, if a taxpayer sells tangible personal property for resale to a foreign subsidiary that is at least 50% owned, and the subsidiary was excluded from the unitary group due to the 80/20 rule, those sales cannot be included in the sales factor numerator. The auditor will have to determine if the foreign subsidiary is at least 50% owned, if unitary ties exist and if the sale is for resale. Sales for use or consumption would not be excluded from the numerator.

The above restriction does not apply to sales of real property or income from intangibles such as royalties and interest.

(2) Other Foreign Sales

Sales of tangible personal property shipped to foreign destinations other than to subsidiaries that are owned more than 50%, are treated as any other non-Illinois destination sale. For throwback purposes the auditor will have to determine if the taxpayer is subject to a tax based on income in the foreign country **and** actually files and pays tax in the foreign country. In the last sentence in IAC § 100.3200(a)(2) it states that the determination of whether a foreign country or political subdivision has the jurisdiction to subject a taxpayer to a net income tax will be determined as if the foreign country or subdivision were a state of the United States.

IAC § 100.9720(c)(8)(B) further clarifies the Departments position regarding the treatment of business activities and sales involving businesses in foreign countries.

Illinois will apply the same principles of protected sales, immunity from taxation, and throwback provisions, to business activities conducted regarding foreign commerce. This will apply whether the sale is from Illinois a company in a foreign country, or if the sale originates in a foreign country and is received in Illinois.

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The Department's position on foreign throwback sales has been upheld in a number of court cases, including:

Beatrice Companies v. IDOR, 292 Ill. App. 3d 532; 685 N.E.2d 958; (1st Dist 1997)

PPG, Industries Inc. v. DOR, 328 O;;/ App3d 16, 765 N.E. 2d 34 (1st Dist. 2002)

However in Morton International, Inc. v. Bower, Docket 01 L 50752, (Cir. Ct. Cook County July 8, 2004), the court held that DOR cannot throw back foreign destination sales if the taxpayer is "taxable" in the foreign jurisdiction, even when the taxpayer is not taxable on those particular sales. This means that if the taxpayer paid an income tax in a foreign country, they are taxable in that country. In this situation, the auditor should confer with the audit supervisor and IT Technical Support as to whether the sales in question are subject to throwback.

Example

Corporation B, an Illinois corporation, is actively engaged in manufacturing farm equipment in Foreign Country Y. Y does not impose a franchise tax measured by net income or a corporate stock tax. It does impose a franchise tax for the privilege of doing business, but B is not subject to that tax because the income tax statute grants an exemption to corporations manufacturing farm equipment. For purposes of allocation and apportionment of B's income, B is taxable in Y. B does not meet the test of IAC Section 100.3200(a)(1)(A), but does meet the test in IAC § 100.3200(a)(1)(B) since Y has jurisdiction to impose a net income tax on B and B can show why it does not owe income tax to Y even though Y has jurisdiction. Ref: IAC § 100.3200(b).

(3) Foreign Treaties

IAC § 100.3200(a)(2)(B) determines whether a foreign country has jurisdiction to tax a "person" using the same standards used for states, and does not have jurisdiction to subject the taxpayer to a net income tax if it would be prohibited from imposing such a tax by reason of the provisions of Public Law 86-272.

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IAC § 100.3200(a)(2)(C) describes the situation where a person is not required to pay net income tax by a foreign country as the result of a treaty provision exempting certain persons, business activities, or sources of income. The protections of PL 86-272 and the determination of whether a state has jurisdiction to subject the taxpayer to a net income tax, will basically afford a foreign nonresident the same protections that a state or political subdivision of the U.S. receives. However, if a treaty with the U.S. government prevents that foreign country from taxing the income, then the person is not taxable in that country and the sale is subject to throwback.

Example

XYZ Corporation is domiciled in Illinois and is a manufacturer of test equipment sold worldwide. The taxpayer claimed that sales shipped from Illinois to a number of foreign countries should not be subject to throwback because under a U.S. treaty the income was not subject to tax since there was no "permanent establishment" in the foreign country. If the foreign country lacks jurisdiction to subject the taxpayer to a tax, then taxpayer is not taxable on income in the foreign country and the sale is subject to throwback.

If no U.S. treaty exempts the income from tax, but that foreign country has no income tax or its income tax law exempts the business for activities of a taxpayer who is doing business in the country, the sale will not be subject to throwback. For that reason, IAC § 100.3200(a)(2)(D) clarifies this situation.

A person is not subject to tax in another state of foreign country if that country or state imposes a tax on net income, unless that country's or state's constitution, statutes or regulations, or courts exempt the person from taxation (and the person can show the specific provision of this exemption).

Some countries including Argentina, Costa Rica, Dominican Republic, Honduras, Lebanon, Panama, Saudi Arabia, and Taiwan impose a tax based on income, but only if the business activities pass a certain threshold. Even if they have nexus under P.L. 86-272, taxpayers don't have to file unless the threshold is passed for that country. In that case, they would not be paying tax only because that country has

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chosen not to tax them. If this is the case, then the auditor should verify that the taxpayers are actually under the threshold, because, if they exceed it, they are not taxable in that country unless they actually file and pay.

If the taxpayer is allowed a foreign tax credit under section 901 of the IRC with respect to a withholding tax, that tax should be considered a "net income tax" for purposes of IAC § 100.3200(a)(1)(A). IAC § 100.3200(a)(2)(A) provides that a net income tax is a tax for which an individual may claim a deduction under 26 USC 164(a)(3) or for which a foreign tax credit may be claimed under 26 USC 901. However, the taxpayer must file an actual return and not just pay the withholding, unless the other country's law expressly provides that, if a taxpayer has sufficient tax withheld, it does not have to file a return.

Example
A domestic taxpayer is subject to a 10% Canadian withholding tax on a loan to a Canadian partnership controlled by the taxpayer. The partnership accrued interest due on the loan during 2001, 2002, & 2003, and in 2003 the partnership withheld 10% of the interest payment to the taxpayer as a tax and reported it on Canadian Form NR4. The withholding is considered a "net income tax" under IAC § 100.3200(a)(1)(A) if the taxpayer claimed a foreign tax credit on federal Form 1118. For throwback purposes the taxpayer is considered taxable in Canada for its 2003 taxable year, but not its 2001 and 2002 year since no tax was paid on those years.

3. COMPUTER SOFTWARE

Receipts from the sale or lease of computer software programs are included in the sales factor whether the programs are "canned" or "custom" in nature. In general, computer software is considered intangible personal property for Illinois income tax purposes. Accordingly, receipts from transactions involving computer software may be included in the numerator of the taxpayer's sales factor as either:

a) Gross receipts from the licensing, sale, or other disposition of a copyright or similar item of intangible personal property under IITA § 304(a)(3)(B-1);

b) Gross receipts from intangible personal property under IITA § 304(a)(3)(C-5)(iii); or

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c) Gross receipts from sales of service under IITA § 304(a)(3)(C-5)(iv).

For taxable years ending prior to December 31, 2008, gross receipts under categories b) and c) would be sourced under IITA § 304(a)(3)(C), which assigns gross receipts based on the income-producing activity.

In general, each transaction involving computer software must be analyzed separately in order to determine which of the above sourcing rules applies. For this purpose, the auditor may rely on federal Treasury Regulations § 1.861-18 Classification of transactions involving computer programs. Treasury Regulations § 1.861-18(b)(1) assigns a transaction involving a computer program into one or more of the following categories:

(i) A transfer of a copyright right in the computer program;
(ii) A transfer of a copy of the computer program (a copyrighted article);
(iii) The provision of services for the development or modification of the computer program;
(iv) The provision of know-how relating to computer programming techniques.

The treasury regulations then provide rules for determining the category into which a transaction is assigned. In addition, Treasury Regulations § 1.861-18(b)(2) states that any transaction consisting of more than one of the transactions described above shall be treated as separate transactions, with the appropriate category being applied to each such transaction. However, any transaction that is deminimis, taking into account the overall transaction and the surrounding facts and circumstances, is not treated as a separate transaction. The auditor may use the federal rules in order to determine which sales factor rule applies.

Transactions categorized federally by applying Treasury Regulations § 1.861-18 produce the following results for sales factor purposes:

a) The transfer of a copyright right in the computer program are assigned for sales factor purposes as gross receipts from the license, sale, or other disposition of a copyright under IITA § 304(a)(3)(B-1);

b) A transfer of a copy of a computer program is assigned for sales factor purposes as gross receipts from intangible personal property under IITA § 304(a)(3)(C-5)(iii);

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c) The provision of services for the development or modification of a computer program are assigned for sales factor purposes as gross receipts from sales of service under IITA § 304(a)(3)(C-5)(iv);

d) The provision of know-how relating to computer programming techniques are assigned for sales factor purposes as gross receipts from the license, sale, or other disposition of a copyright under IITA § 304(a)(3)(B-1).

Treasury Regulations § 1.861-18 provide eighteen examples illustrating the categorization of transactions to various fact patterns. The auditor may consult these examples for further guidance. Four of these examples are in the Exhibits and Historical Extracts section for reference.

4. BUSINESS INTANGIBLES

This section covers the following:

- Net gains from the sale of intangibles / Interest income
- Royalties and other income from intellectual property including gains and losses from the sale of that property

It is the auditor's responsibility to obtain evidence necessary to establish whether or not the income producing activity generating the intangible income can be identified: What funds are used to invest? Who decides to invest in a particular vehicle? Who monitors the account balances? What is done when the investment becomes unproductive? If the answers to these and any other questions indicate company personnel are actively involved in the investment activity, the income producing activity can be linked to the income recipient.

Receipts from real and tangible personal property or receipts from sales of services are discussed later.

a) Net Gains From the Sale of Intangibles / Interest Income

IAC § 100.3380(c)(3), (4) and (5) deal with income from intangible personal property. If the income producing activity in respect to the income from the intangible property can be readily identified and the income is considered business income, the income should be included in the sales factor. If the

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income producing activity cannot readily be identified, the income cannot be included in the sales factor.

Note: IAC Section 100.3380 only covers three-factor filers under IITA Section 304(a). It does not cover receipts under other subsections of Section 304 including financial organizations.

Only the net gains from the sale of intangible personal property are included in the sales factor under IAC § 100.3380(c)(5). This special rule applies to sales of intangibles in the ordinary course of business, and not to "occasional sales" that are excluded entirely from the numerator and denominator of the sales factor under IAC § 100.3380(c)(2). The gross receipts' rule under IAC § 100.3370(a)(1)(E) is disregarded.

Under this special rule, losses and gains are netted, however, no amount less than zero will be included in the sales factor. For example, if a taxpayer during the year:

1. Sells intangible A at a gain of $5.00 and
2. Sells intangible B at a loss of $8.00

The amount which would be included in the sales factor due to the sale of intangibles would be $-0-.

Interest income included in Illinois base income (net of modifications) is included in the sales factor. This includes interest on state obligations excluded from federal taxable income but included on the Illinois return as an addition modification. Ref: IAC § 100.3370(a)(2)(D). Interest income allowed as an Illinois subtraction modification is excluded from the sales factor. (Ref: IAC § 100.3370(a)(2)(C)(i))

b) Sales Numerator – Interest & Gains on Intangibles

(1) Tax Years Ending On Or After December 31, 2008

(a) A Dealer of Intangible Personal Property Within the Meaning of IRC Section 475

For tax years ending on or after December 31, 2008, the Act contains a special rule for a dealer in intangible personal property within the meaning of IRC Section 475 (26 USCA 475).

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Under IITA § 304(a)(3)(C-5)(iii)(a) the income or gain is received in this state if:

- the customer is an individual, trust or estate who is a resident of this State, or
- for all other customers, if the customer's commercial domicile is in this state.

Note: The customer shall be deemed to be a customer in this State if the billing address of the customer, as shown in the records of the dealer, is in this State (unless the dealer has actual knowledge of the residence or commercial domicile of a customer during a taxable year).

Section 475(c)(1) defines the term "dealer in securities" as a taxpayer that:

> (A) regularly purchases securities from or sells securities to customers in the ordinary course of a trade or business; or
>
> (B) regularly offers to enter into, assume, offset, assign or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

For this purpose, a taxpayer is a dealer with respect to an item of intangible personal property if the taxpayer is actually a dealer with respect to the item under IRC Section 475, or would be a dealer with respect to the item under IRC Section 475 if the item were a security as defined in IRC Section 475(c)(2). Taxpayers in the business of selling a certain intangible item assign gross receipts based on the location of their customers, while taxpayers not in the business of selling such item assign gross receipts based on the income-producing activity.

Note: A web-based discount membership club in CT & NY offers discounts for hundreds of third-party attractions, hotels, restaurants, etc. for which it receives

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membership fees. The club occasionally sends employees to Illinois to sign up merchants. The member contacts the merchant directly for services. If the taxpayer meets the definition of a dealer under IRC Section 475, then the receipts are allocated to the location of the customer. If not, then the receipts are allocated under the cost of performance rule in IITA § 304(a)(3)(C-5)(iii)(b).

(b) Taxpayers Who Are Not Dealers

For calculating the Illinois sales numerator of a taxpayer who is not a dealer with respect to an intangible, IITA § 304(a)(3)(C-5)(iii)(b) provides that income from the intangible is sourced to Illinois:

- if the income-producing activity of the taxpayer is performed in this state, or;
- if the income-producing activity of the taxpayer is performed within and without this state and the greatest proportion is in Illinois compared to other states based on performance costs.

This eliminates the requirement that none of the sale is sourced to Illinois if the cost of performance in Illinois is less than 50%. The sale will be sourced to Illinois if a "greater proportion" of the cost of performance is in Illinois than any other single state. For example, if the cost of performance on a single income-producing activity is determined to be 30% Florida, 30% Indiana, and 40% Illinois, 100% of the receipt will be sourced to Illinois.

(2) Tax Years Ending Before December 31, 2008

Interest income, services charges, gain on sale of property **not** connected with sale of real estate or tangible personal property is sourced under IAC § 100.3370(c)(3), which states that sales other than sales of tangible personal property are in Illinois when:

- The sales factor includes gross receipts from transactions other than sales of tangible personal property (including transactions with the United States Government)

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- These gross receipts are attributed to Illinois because the income producing activity giving rise to the receipts is performed in Illinois or;
- Regarding a particular item, its income producing activity is performed in Illinois based on costs of performance.

c) Dividend Income

IITA § 304(a)(3)(D) states the provisions for the treatment of dividend income.

- For taxable years ending on or after December 31, 1995 dividend income shall not be included in the numerator or denominator of the sales factor:
- Amounts included under Section 78 of the Internal Revenue Code, and Subpart F income as defined in Section 952 of the Internal Revenue Code are excluded from the Illinois sales factor numerator and denominator.

Prior to 1995, dividends, net of any dividend subtraction modifications, were included in the sales factor.

d) Royalty Income

For taxable years ending on or after December 31, 1999, gross receipts from the licensing, sale, or other disposition of a patent, copyright, trademark, or similar item of intangible personal property may be included in the sales factor only if the gross receipts from licenses, sales, or other disposition of such items comprise **more than 50%** of the taxpayer's total gross receipts included in gross income during the tax year and during each of the 2 immediately preceding tax years; provided that, when a taxpayer is a member of a unitary business group, such determination shall be made on the basis of the gross receipts of the entire unitary business group. This is commonly referred to as the 50% B-2 test in IITA § 304(a)(3)(B-2). If not excluded from the sales factor under the 50% B-2 test, these receipts are sourced according to IITA § 304(a)(3)(B-1).

In computing the numerator of the 50% B-2 test (B-2 receipts), gross receipts include:

- Amounts received as damages or settlements from claims of infringement.

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- Gross receipts from the licensing, sale, or other disposition of a patent received from a person using the patent in the production, fabrication, manufacturing or other processing of a product or from a person producing, fabricating or manufacturing a product subject to a patent.

- Gross receipts from the licensing, sale, or other disposition of a copyright received from a person engaged in printing or other publication of the material protected by the copyright. The term does not include gross receipts from publishing, broadcasting or advertising within the meaning of IAC § 100.3373.

(SEE EXAMPLES OF THE B-2 TEST ROYALTY DETERMINATION IN ARCHIVE – EXHIBIT SECTION)

(1) Royalties – Sales Numerator

If it is determined that the B-2 receipts should be included in the sales factor under subsection B-2, Section 304(a)(3)(B-1) provides that the receipts are sourced to Illinois to the extent that the intangible personal property associated with the receipts is utilized in Illinois.

Patents are utilized in Illinois to the extent that they are employed in production, fabrication, manufacturing, or other processing in Illinois OR to the extent that a patented product is produced in Illinois. **Copyrights** are utilized in Illinois to the extent that printing or other publication originates in Illinois.

If patents or copyrights are utilized in more than one state, the receipts received by the taxpayer associated with the patents or copyrights are sourced to Illinois based on a fraction:

- The numerator of the fraction is the gross receipts of the licensee or purchaser from the utilization of the patents or copyrights within Illinois, and

- The denominator of the fraction is the total gross receipts of the licensee or purchaser from the utilization of the patents or copyrights everywhere.

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Trademarks and other similar items of intangible personal property are utilized in Illinois if the commercial domicile of the licensee or purchaser is in Illinois.

If the taxpayer does not have sufficient information in its books and records, or the books and records of a person "related to the taxpayer", to determine where an item of B-2 property is utilized by the licensee or purchaser, the gross receipts attributable to that item of property are excluded from the taxpayer's sales factor numerator and denominator. This information may be available in, for instance, the contractual agreements relating to the intellectual property. The taxpayer may also attempt to obtain utilization information from unrelated licensees, however, we cannot demand that the taxpayer obtain such information.

If the agreement is between the taxpayer and a related person, however, we can demand to review the books and records of that related person to determine the utilization location. IRC Section 267(b) is used to determine whether a person is "related to the taxpayer" for the B-2 books and records provision. Section 267(b) recognizes many different types of relationships. The ones most commonly encountered are listed below. For more information, refer to IRC Section 267(b).

Corporations that are members of the same controlled group. A controlled group is:

- A group of corporations that are more than 50% owned, directly or indirectly, by a common parent, or

- Two or more corporations, if 5 or fewer persons who are individuals, estates or trusts own more than 50% of the stock of each corporation.

- A corporation and a partnership if the same persons own more than 50% of the stock of the corporation and more than 50% of the capital interests or profits interest of the partnership.

- An individual and a corporation if more than 50% of the value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the individual.

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- An S corporation and another S corporation if the same persons own more than 50% of the stock of each corporation.

- An S corporation and a C corporation if the same persons own more than 50% of the stock of each corporation.

- Members of a family. Family is defined as brothers and sisters (whether by the whole or half blood), spouse, ancestors and lineal descendants.

5. RECEIPTS FROM THE SALE OR LEASE OF REAL OR TANGIBLE PERSONAL PROPERTY

Special rules for determining when the income producing activities are performed in this State may be found in IAC § 100.3370(c)(3)(D).

IAC § 100.3370(c)(3)(D)(i) states that gross receipts from the sale, lease, rental or licensing of real property are in this State if the real property is located in this State.

IAC § 100.3370(c)(3)(D)(ii) states that:

- The principal cost of performance in a rental, leasing or licensing transaction is the depreciation or amortization of the tangible personal property, and the depreciation or amortization expense is incurred in the state in which the tangible personal property is located.

- The rental, lease, licensing or other use of tangible personal property (TPP) in this State is a separate income producing activity from the rental, lease, licensing or other use of the same property while located in another state.

- If property is within and without this State during the rental, lease or licensing period, gross receipts attributable to this State shall be measured by the ratio which the time the property was physically present or was used in this State bears to the total time or use of the property everywhere during such period.

Example

Corporation X is the owner of 10 railroad cars. During the year, the total of the days each railroad car was present in this State was 50 days. The receipts attributable to the use of each of the railroad cars in this State are a separate item of income. Total receipts attributable to this State shall be determined as follows:

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(10 x 50)/3650 x Total Receipts

Note: For tax years on or after December 31, 2008 the IAC § 100.3700(c)(3)(D)(i)&(ii) was copied into the IITA § 304(a)(3)(C-5)(i)&(ii). Whereas the IAC Section uses the term "gross receipts" in its definition, the IITA definition relies on the term "sales". Effectively they are the same.

Example

Taxpayer buys advertising space on the sides of Chicago city buses and then rents the space to advertisers. Taxpayer has no employees in the state and no other business activity in the state. Under Section 304(a)(3)(C-5)(ii) the rental payments are in Illinois to the extent that they apply to Chicago bus routes, since the buses are tangible personal property.

Example

In 2008 a taxpayer provides administrative services, maintenance and repair assistance services, and other related services to lessees of mobile property. This includes paying bills on behalf of the customer, arranging for maintenance and repairs, preparing government licenses, etc. Customers pay the taxpayer a monthly fee for this service. Since the subject matter of the administrative services performed by the taxpayer is the customer's tangible personal property, the services are received in Illinois to the extent that the property is located in Illinois. If the location of the property cannot be determined, then the sale is allocated to the location of the office of the customer from which the services are ordered. If that cannot be determined, then the sale is allocated to the customer's billing address.

6. SALES OF SERVICE

Sales of Service – TYE **before** December 31, 2008 (see Archive/Historical Extracts)

a) Sales of Service - TYE on or **After** December 31, 2008

Telecommunication services and broadcast services rules are under IITA § 304(a)(3)(B-5) & (B-7). Those rules are not covered under this section. See separate sections for telecommunications and broadcasting.

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IITA § 304(a)(3)(C-5)(iv) describes the treatment of sales of service. This section is broken down into its component sentences below with further meaning of the sentence following the components in italics:

- Sales of service are in this State if the services are received in this State.

  This applies to all taxpayers-corporate, individual, partnership, trust, etc. All of them source sales of service to the state where the service is received.

- For the purposes of this section, gross receipts from the performance of services provided to a corporation, partnership, or trust may only be attributed to a state where that corporation, partnership, or trust has a fixed place of business.

  When the customer is a corporation, partnership or trust, a sale of service cannot be sourced to a state unless the customer has a fixed place of business in that state. This rule also applies to all taxpayers-corporate, individual, partnership, trust, etc. It does not apply when the customer is an individual or an estate.

- If the state where the services are received is not readily determinable or is a state where the corporation, partnership, or trust receiving the service does not have a fixed place of business, the services shall be deemed to be received at the location of the office of the customer from which the services were ordered in the regular course of the customer's trade or business.

  If there is no fixed place of business in the state where the services are received by a corporation, partnership or trust, or if the place of sale cannot be readily determined, the receipts are sourced to the customer's ordering office.

- If the ordering office cannot be determined, the services shall be deemed to be received at the office of the customer to which the services are billed.

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If the second step would source the sales to the customer's ordering office, but that office cannot be determined, the sales are sourced to the place where the service provider sends its bill.

- If the taxpayer is not taxable in the state in which the services are received, the sale must be excluded from both the numerator and the denominator of the sales factor.

  If the taxpayer is not subject to tax in the state to which the sales are sourced under the first 3 steps, the sales are excluded from both the numerator and denominator.

Note: The only difference between individual customers and other customers is the fixed place of business rule. With the exception of the fixed place of business provision, the provisions of IITA § 304(a)(3)(C-5)(iv) for businesses and individuals are the same.

The last portion of IITA § 304(a)(3)(C-5)(iv) is the "throw out" provision of the statute. See section below on the "throw out" provisions.

Example

A taxpayer with no physical presence in Illinois operates a call center outside of Illinois to facilitate maintenance work for a variety of corporate retailers. Once a repair order is received from a retailer, the taxpayer uses its own software to locate an outside vender to provide the best service at the best price. The taxpayer arranges for the service and then bills the retailer for the cost of the service plus a markup. Prior to 2008 none of the receipts would be included in the Illinois numerator because the taxpayer has no cost of performance in Illinois. However for tax years ending on or after December 31, 2008, if the taxpayer has nexus under the U.S. Constitution, then the sale is allocated to Illinois if the customer has a fixed place of business in Illinois, which would be the location of the Illinois retailer. In the event that cannot be determined then the sale is allocated to the location of the office of the customer from which the services are ordered. If that cannot be determined, then the sale is allocated to the customer's billing address.

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(1) Fixed Place of Business

Under IITA § 1501(a)(9.5) the term fixed place of business has the same meaning as that given in IRC § 864 and related Treasury Regulations. IAC § 100.3405(b)(1) further provides that a fixed place of business is a facility such as a place, site or structure through which the taxpayer operates its business; and that:

- A taxpayer does not have a fixed place of business in Illinois merely because it sporadically uses the office of a related company such as a subsidiary.

- A fixed place of business used by an agent of the taxpayer is not a fixed place of business of the taxpayer unless the agent "has the authority to negotiate and conclude contracts in the name of the taxpayer, and regularly exercises that authority." Ref: IAC § 100.3405(b)(1)(C).

- A fixed place of business used by an independent agent of the taxpayer is never a fixed place of business of the taxpayer. An independent agent means a "general commission agent, broker or other agent of an independent status acting in the ordinary course of his or her business in that capacity." Ref: IAC §100.3405(b)(1)(E).

Example

A taxpayer in Texas provides poker training to individuals via the internet. Fees received for taxable years ending on or after December 31, 2008 are included in the Illinois numerator if the customer's billing address is in Illinois. Prior to 2008 none of the receipts would be included in the Illinois numerator since there is no cost of performance in Illinois.

(2) Throw Out Provision Under 304(a)(3)(C-5)(iv)

Under IITA § 304(a)(3)(C-5)(iv), if the taxpayer is not taxable in the state in which the services are received, the sale must be excluded from both the numerator and the denominator of the sales factor.

Whether the sale can be excluded from the sales factor depends upon if the taxpayer is taxable where the services are received or not, as

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stated in the provision above. The sale can only be thrown out of the factor if the taxpayer is not taxable where its customer receives the services that were provided. IITA § 303(f) provides guidance on what is considered taxable in another state. For purposes of allocation of income a taxpayer is taxable in another state if:

- In that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business or a corporate stock tax; or

- that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

In order to be "subject to tax" under the first prong, the taxpayer must actually pay a tax that is related to its income-producing activities in the state. A minimum tax for the privilege of doing business does not qualify, because it is not related to income-producing activities. If no tax is paid, the taxpayer is not subject to tax. See IAC § 100.3200(a)(2).

In contrast, under the second prong of the "taxable in another state" test, if the taxpayer has nexus, but the other state's law causes the taxpayer to have no liability, the taxpayer is subject to tax even though no tax is paid. If the taxpayer can show that it has nexus and is in **compliance** with the other state's law in not paying tax, the service income remains in the denominator.

Example

Illinois taxes services on a marketplace approach. Indiana is a cost of performance state. A multistate company provides legal services which are sold to a customer, and received in Indiana with the actual legal work being done more than 50% in Illinois. Indiana, a cost of performance state, will not assess tax. Illinois, a marketplace based state, will also not include the sales in the apportionment factor numerator but allow the sales to remain in the denominator. If the services were sold in a marketplace state and the taxpayer did not pay tax, they would **not be in compliance** with that state and the sales would be "thrown out" of the Illinois denominator.

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As of November 1, 2012 there were thirteen states which use market based sourcing rules:

Alabama, Arizona, California, Georgia, Illinois, Iowa, Maine, Maryland, Michigan, Minnesota, Oklahoma, Utah, Wisconsin.

REF: AICPA Tax Advisor, November 1, 2012.

Another situation that will cause the taxpayer to be in compliance with another state's law, while incurring no income tax liability, if sales of services can be found in the taxation of S-corporations and partnerships. Very few states actually tax S corporations on their income. With the exception of Illinois, virtually no states tax partnerships on their income.

b) Telecommunications

Under IITA § 304(a)(3)(B-5) and IAC §100.3371, sales of telecommunication, **for TYE on or after December 31, 2008**, services are allocated under six subparagraphs:

- Individual call-by-call
- Postpaid telecommunications
- Prepaid telecommunications
- Private communication services
- Ancillary services
- Receipts to access a carrier's network

(1) Individual Call-By-Call

The receipts are in Illinois if:

- The call both originates and terminates in Illinois
- The call either originates or terminates in Illinois and the service address is located in Illinois. The service address is defined as:
- The location of the telecommunications equipment to which a customer's call is charged
- If that location is unknown, then the signal's origination point

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- If that is also unknown, then the location of the customer's place of primary business

(*2*) Postpaid Telecommunications

These are credit card calls and calls charged to a telephone number other than the number from which the call originated or at which the call terminated. The sale is in Illinois if the signal's origination point is in Illinois.

(*3*) Prepaid Telecommunications

This is prepaid services (such as phone cards) sold in predetermined dollar units which allows access to a network by entering an access number or authorization code. The receipts are in Illinois if the user acquired the prepaid card from a retailer in Illinois. Receipts from recharging the phone card are in Illinois if the purchaser's billing information indicates a location in Illinois.

(4) Private Communication Services

This is private lines over secure channels for purposes of voice or data transmissions such as for credit card verification and debits, computer transmission and internet. Receipts from private communication services are in Illinois if:

- The charges for each channel with a termination point in Illinois.
- The charges for the "total channel mileage between each channel termination point" are in Illinois.
- 50% of the receipts are in Illinois if either the origination point and termination point is in Illinois and the charges are separately billed for each point.
- If the receipts in the preceding example are not separately billed, the receipts are in Illinois based on a percentage determined by dividing the number of customer channel termination points in Illinois by the total number of customer channel termination points everywhere.

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(5) Ancillary Services

Ancillary services are separately billed items that are incidental to the supplying of telecommunications services including: Individual call information separately stated, directory assistance, advanced call features such as, teleconferencing, caller ID and voicemail.

Receipts from ancillary services at retail are sourced to the customer's primary place of use of those services. If the service provider cannot determine the state of use, then it is sourced to the location of the purchaser.

(6) Receipts to Access a Carrier's Network and from Sales of Telecommunications Services for Resale.

These receipts are sourced to Illinois under four paragraphs:

- If 100% of the receipts are for access fees attributable to intrastate communications that originate and terminate in Illinois, then the receipts are in Illinois.

- 50% of the receipts from access fees are in Illinois if the call either originates or terminates in Illinois.

- 100% of the receipts on interstate calls are in Illinois if the customer's service address is in Illinois.

- Receipts from ancillary services provided to other telecommunication providers for resale are sourced to Illinois using "the apportionment concepts used for non-resale receipts of telecommunications services if the information is readily available to make that determination. If the information is not readily available, then the taxpayer may use any other reasonable and consistent method." Ref: IAC § 100.3371(h)(4).

For tax years ending prior to December 31, 2008

Receipts from telecommunication services for tax years ending prior to December 31, 2008 are allocated based on cost of performance. (See cost of performance section in Historical Extracts and Exhibit section at end of chapter.)

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c) Publishing Industry

(1) For Tax Years Ending On Or After December 31, 2008

IITA § 304(a)(3)(C-5)(iv) provides guidance for determining where publishing services are received. This Section applies only to the gross receipts from publishing services of a taxpayer who is required to source these gross receipts under IITA§ 304(a)(3)(C-5). Specific rules regarding publishing services are found in IAC §100.3373 which lists four key definitions.

- Circulation factor
- Publication or published material
- Publishing or publishing services
- Purchaser and subscriber

The circulation factor is a ratio computed on published material containing advertising. It is expressed as in state purchasers/subscribers of published material to purchasers/ subscribers everywhere. The determination of the circulation factor can be based upon:

- The geographic location of the purchaser/subscribers.
- The books and records of the taxpayer
- Rating statistic sources such as Audit Bureau of Circulations, Internet World Stats or comparable sources. The source selected should be used consistently from year to year for that purpose.

Publication or published material includes the physical or printed version of any thought or expression: a play, story, article, column, literary, commercial, educational, artistic or other written or printed work. This printed work may be in the form of a book, magazine, periodical, trade journal or any other form of printed matter including internet, but not broadcasting.

Publishing or publishing services means deriving business income from publishing, selling, licensing (excluding licensing to another person for printing/publishing licensed material) or distributing

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newspapers, periodicals, trade journals or other published material. Publishing or publishing services does not include:

- Delivery of materials published by a third party.
- Delivery or materials by the taxpayer when billed separately

Delivery fees charged by a non publisher who merely delivers (newspaper carrier), or that are charged separately by the publisher are sourced under IAC §100.3373(b)(3)~~3370(c)(5)~~

Purchaser and subscriber are the resident, or business, that is the recipient of the published item. This does not include a wholesaler, retailer or other distributor of the published item.

Publishing sales within Illinois include:

- Gross receipts derived from the sale of published materials as **tangible** personal property.

- Gross receipts derived from the sale of published materials from **non tangible** personal property: property from advertising and from the sale, rental or other use of the taxpayer's customer lists for a publication or portion of publication is attributed to Illinois using the taxpayer's circulation factor. Ref IAC § 100.3373(c)

In IAC § 100.3373(d), the treatment of the sales of non tangible personal property lists the situations when the gross receipts from these sales can be included in the sales factor or thrown out, as provided for in IITA § 304(a)(3)(C-5)(iv). IAC § 100.3373(d) mirrors the previously listed throw out provisions. The gross receipts from the performance of publishing services will be attributed to a state based on if the entity providing publishing services has a fixed place of business in that state, or not. When the circulation factor is determined by a method other than the taxpayer's own books and records this does not apply.

- If it cannot be determined where the publishing services are received, or the receiving entity does not have a fixed place of business the location of the ordering office will be used. When the circulation factor is determined by a method other than the taxpayer's own books and records this does not apply.

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- If the ordering office cannot be determined, the billing office will be used. When the circulation factor is determined by a method other than the taxpayer's own books and records this doesn't apply.

- If the taxpayer is not taxable in the state in which the publishing services are received, the sale must be excluded from both the numerator and the denominator of the sales factor.

(2) For Tax Years Ending Prior to December 31, 2008

Receipts from publishing, including advertising, are allocated based on cost of performance. Whether a specific type of revenue is classified as being received from tangible or intangible sources is important in the computation of the sales factor of the apportionment formula. If the revenues are considered intangible in nature (received as a result of the performance of services, for example), the income is assigned to the state where the income producing activity takes place. If the revenues are considered tangible in nature (received as a result of sales of tangible personal property), they are generally assigned to the state of destination of the sale.

The Illinois appellate court in New Yorker Magazine, Inc., vs. the Department of Revenue upheld the Department's position that the sale of advertising space is an integral part of the publication and sale of magazines and periodicals and that the revenues from these types of sales should, therefore, be classified as tangible in nature. The court felt that the advertising revenues were merely one part of the creation of the magazine as a whole since the magazine publisher did not perform any traditional advertising services such as creating the advertising concept or writing or designing the copy.

Because of this classification of the revenues as being tangible in nature, the income from the sale of advertising space could be assigned to Illinois based on the percentage of publication functions taking place.

Refer to Chapter 37(new 49) for a synopsis of the New Yorker Magazine case and the complete case citation.

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When auditing publishing businesses, these types of revenues and the activities surrounding them should be examined for possible classification as tangible receipts and for inclusion in the Illinois numerator of the sales factor based on the destination of the sales of the related tangible product due to the amendment of IITA § 304(a)(3)(B)(ii).

"The premises of a person who has independently contracted with the seller for the printing of newspapers, periodicals or books shall not be considered to be an office, store, warehouse, factory or other place of storage for purposes of [the sales factor]..."

This prohibits an independent printer's premises to be a point of origin for throwback sales purposes.

Advertising revenues should not, however, be considered sales of tangible personal property in every case in which sales of advertising space occurs. For instance, if the taxpayer is an advertising agency or, in addition to producing tangible personal property for sale, is also involved in creating advertising or performing other advertising services which ARE separable from the tangible property being sold, the revenues from these activities may properly be considered intangible in nature and assigned to the apportionment formula based on the location of the income producing activity.

d) Sports Team Receipts

All receipts of the sports team or organization should be included in the sales factor. Some examples of the types of receipts involved follow:

1. Gate receipts, attributed to each team in accordance with the league or association arrangement where there is a realistic division. In some cases the home team may receive 100% of the gate receipts while in other situations the visiting team may receive a portion of the gate receipts. Also some entertainers may simply receive a set fee for their services while others may receive a share of the ticket sales. Individual contracts and arrangements must be examined to determine the proper amount of receipts, which should be included in the denominator.

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Gate receipts would be attributed to Illinois if the event took place in Illinois.

2. The allocation of receipts from contracts entered into for the production and broadcasting of sporting events is based on the contracts involved. Receipts for the physical production of events, which take place in Illinois, are attributed to Illinois per IAC §100.3370(c)(3)(D)(iii) . Receipts for the rights to broadcast the events and receipts from commercial advertising would be attributable to Illinois if the income-producing activity is performed in Illinois, based on cost-of-performance.

3. Receipts from player contract transactions and franchise fees. This income is considered intangible in nature, therefore they would be assigned to the state where the income-producing activity is managed and controlled.

4. Receipts from concession income, attributed to the physical location where the activity, which gave rise to such, receipts occurred.

e) Broadcast Industry

(1) Tax Years Ending on or After December 31, 2008

IITA § 304(a)(3)(B-7) applies to radio and television broadcasting (including cable and satellite broadcasting). For taxable years ending on or after December 31, 2008, the following sales are in Illinois:

- For advertising revenue from broadcasting, the customer is the advertiser and the service is received in Illinois if the commercial domicile of the advertiser is in this State.

Example
The XYZ Corporation operates a chain of restaurants in multiple states but has its commercial domicile in Illinois. ABC contracts with the Smith Corporation, an advertising agency, to create commercials to be aired in a number of states. Smith creates the commercials and then contracts with broadcast companies on behalf of XYZ in various states to air the commercial. The broadcasting companies will include 100% of their advertising receipts received from XYZ in their sales numerators because XYZ has its corporate headquarters in

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Illinois. It is irrelevant that Smith Corporation contracted with some non-Illinois broadcast companies or that Smith Corporation created the programming outside of Illinois.

- For fees paid to the broadcaster by the recipient (viewer or listener of the broadcast), service is received in Illinois as measured by the portion of recipients located in this state.

- For fees paid to the broadcaster by the person who provides the programming, the portion of broadcast service received by the broadcaster is in Illinois as measured by the portion of recipients located in this state utilizing the audience factor.

In this scenario, the graphic provides that the fees paid to the TV Distributors, Networks or Local Stations may come from either: Content Creation or Networks & Local Stations and are sourced based on the location of the end Consumer.

Example

In 2009 Allen Cable Company, located in Danville, Illinois, receives a $10,000 fee from Viacom to broadcast a National Geographic program. Allen's books and records indicate that 80% of its cable subscribers that are eligible to receive the cable channel that will air the show (based on the individuals' cable contract) are in Illinois. Allen Cable will include $8,000 in its Illinois sales factor (10,000 x 80%).

Note: Only the subscribers who can receive the channel count.

Example

In 2009 Jones Radio Broadcasting in Moline, Illinois received $5,000 in fees to air a syndicated radio show. The Arbitron ratings (similar to the Nielsen ratings) indicate that its audience share is split evenly between Illinois and Iowa. Jones will include $2,500 (5,000 x 50%) of the fee in its Illinois sales factor.

a) Fees, paid by the broadcaster to a network or station who provides the programming, are sourced to the business location of the broadcaster from which the broadcasting service was ordered.

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In the following illustration, this is shown as the flow of fees paid by the TV Distributors to the Networks & Local Stations.

Example

John Doe is an Illinois resident and a subscriber to Jones Cable Services to provide television programming for a monthly cable fee. Mr. Doe orders a pay-per-view program and pays Jones Cable a $10 fee for providing the program. Jones includes the fee in the Illinois numerator since program is received by a customer in Illinois.

b) Fees paid by the broadcaster to a person who provides the programming that is not a network or station, are sourced according to the business location of the broadcaster from which the programming was ordered.

This is illustrated below as the TV Distributors paying fees to the Content Creation providers.

Time Warner Cable offers the following graphic on their website, twccommunications.com, which helps to illustrate some of the information provided in (B-7).

Example

Corp A produces syndicated television shows in New York. Corp A receives $10,000 from Corp B, a broadcaster located in Chicago, for the rights to broadcast a program. Corp B ordered the program from its Chicago offices. Corp A includes the sale in its Illinois sales numerator since the customer ordered it from an office in Illinois. It is irrelevant what Corp B does with the program. Note that if Corp A and B are in the same unitary business group, the $10,000 received by Corp A will be subject to an intercompany elimination.

Note: There is no so-called throw out rule for broadcasting services, which excludes from the sales factor sales to a state where the taxpayer is not subject to tax.

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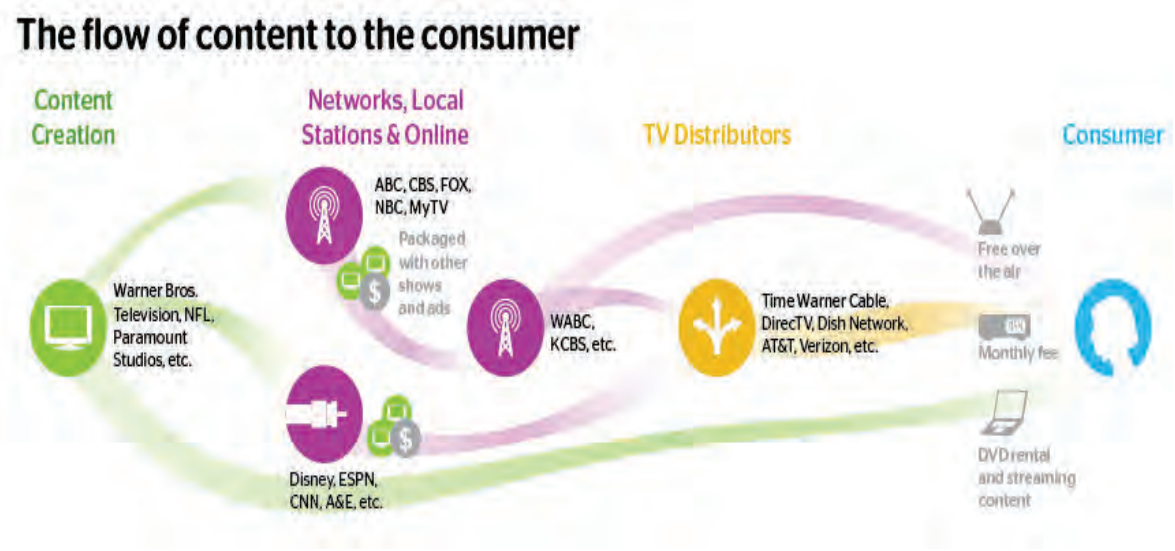

(2) Broadcast Industry - TYE Prior to December 31, 2008

For taxable years ending before December 31, 2008, all broadcasting receipts fall under IITA § 304(a)(3)(C) which states that sales other than sales governed by paragraph (B), sales of tangible personal property) and (B-1) Patents, copyrights, trademarks and similar items) are in this state if:

- The income-producing activity is performed in Illinois; or
- The greater percentage of income generating activity is performed in Illinois, than other states based on costs of performance.

(a) Selling Programming to Broadcast Companies

Programming revenues, including any advertising associated with the program, are based on costs of performance. Some revenues from cable companies are from the rights to broadcast the programming, but the majority of the revenues are from commercial minutes built into the shows.

The income producing activity has to be identified, which is likely to be each individual contract for programming. The majority of

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the costs of performance are likely to be in the state where the show is produced.

Example 1

Company A located in New York produces a TV program which it then sells to broadcast companies throughout the U.S. In 2006 it receives $10,000 from a TV station in Illinois to broadcast the show. The income producing activity is the production of the show and the costs of performance are the direct costs in producing the show. None of the receipts can be included in the numerator of Company A since the costs of performance are in New York.

Example 2

In 2007 Company A in Chicago pays $10,000 to buy a syndicated show produced by Company B in New York, an unaffiliated company. Company A then sells the rights to the show to Company C in Gary, Indiana for $15,000 which will then be broadcast to viewers in Illinois and Indiana. Company A includes 100% of the $15,000 sale to Company C in its numerator. The costs incurred by Company B to produce the show are irrelevant since third-party costs cannot be included as direct costs in Company A's costs of performance test under IAC § 100.3370(c)(3)(A). In addition, it is irrelevant what Company C does with the program.

Example 3

The same facts in Example 2 except that Company A and Company B are members of a unitary business group. The 50% costs of performance test is applied on a unitary basis in which case the costs incurred by Company B are included in the costs of performance test of Company A, for that particular activity. In this case, greater than 50% of the costs of performance is likely to be in New York where the show is produced, and if so, then none of $15,000 in receipts would be included by Company A in its numerator.

Example 4

Company A in Ohio, with no employees or operations in Illinois, produces TV ads for various companies that want to advertise

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their products. In 2007 Company A receives a contract for $100,000 from Company B in Indiana to produce a TV ad and to pay TV stations to air it. Company A sends a mobile truck and film crew to Illinois to produce the ad, and then pays a TV station in Fort Wayne, Indiana (with no viewers in Illinois) $50,000 to air the ad to viewers in Indiana and Ohio. Company A incurred $30,000 in direct costs to produce the ad with $20,000 of the direct costs incurred in Illinois and $10,000 incurred in Ohio. Company A has nexus in Illinois due to the temporary Illinois presence of the film crew. Activities of third-parties including activities of the TV station in Indiana are not income-producing activities of the taxpayer, so that the $50,000 paid to the Indiana station cannot be considered in Company A's costs of performance test. Since greater than 50% of the direct costs of producing the ad was incurred in Illinois, all of the $100,000 in receipts from Company B is included in Company A's sales numerator. It is irrelevant that the ad was never viewed in Illinois.

(b) Local Broadcast Studio – TV or Radio

This would consist of newsroom operations as well as the broadcasting of daily or weekly programs, movies, and sporting events. Revenues from operating a broadcast studio will consist generally of:

- Advertising revenue
- Monthly cable fees
- Pay-per-view

(i) Advertising Revenues

Generally, product advertisers are buying minutes based on the type of show or event since different advertising rates are involved for each show, especially as they relate to the time of day. Therefore the income producing activity is the broadcasting of ads during the various shows. The taxpayer will have to give the auditor a breakdown of the specific ad revenues and identify the specific programming when those ads were run. The auditor should contact CAA

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to develop a statistical sample. The next step would be to identify the direct costs associated with the income producing activities chosen for the test check.

There are four possibilities for sourcing an ad receipt:

- The ad could have been run while broadcasting a program that was purchased from a unitary company.
- The ad could have been run while broadcasting a program purchased from a non-affiliated company.
- The ad could have been run while broadcasting one of its own programs produced locally, such as a local news program or local sporting event.
- The ad could have been run during a combination of the above.

If the broadcast company is unitary with companies that are providing the programming, then the unitary group's cost of producing national news stories, movies, national game shows, etc will have to be included in the costs of performance test. The auditor will have to work with the taxpayer to develop a cost figure for the shows that are produced. However the cost of the programming received from unitary companies will not include mark-up, executive officer salaries, administrative costs, rent and depreciation on those portions of the buildings not involved in production, and payments made to non-unitary companies to bounce the signal off of a satellite.

If the broadcast company is not unitary with the producer of the shows, then all payments made to those producers or suppliers will be excluded from the costs of performance test since they are for third-party activities, not activities of the taxpayer.

The ad could have been shown during the broadcast of a locally produced news show, local sporting event, or other

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local programming. For local programming the direct costs will be:

- Wages and benefits for news reporters, camera crews, and studio workers directly involved in producing newscasts.

- Depreciation or rent expense on camera and broadcasting equipment, television vans, and other equipment used by reporters and cameramen.

- Depreciation, rent expense, and utility costs on the portion of the building used for newsroom operations and areas of the building directly involved in sending the signal to the TV viewer or cable subscriber. This would include broadcast towers and satellite dishes owned by the taxpayer.

The cost of programming paid to third parties that are not members of the unitary group along with news wire stories and other third-party payments will not be included in costs of performance. These are third-party activities under IAC § 100.3370(c)(3)(A).

If a broadcast company sends a crew to broadcast a sporting event, then greater than 50% of the costs of performance is likely to be at the location of that event. Ref: IT 88-0243.

If the ad was run during a combination of programming, then some proration will be needed.

(ii) Cable Fees and Pay-Per-View

Revenues are primarily fees paid by cable subscribers. This income also falls under the costs of performance rules. The direct cost included in the costs of performance tests include:

- Most of the direct costs determined under advertising above, except for third-party costs

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- Depreciation and maintenance on cable lines
- The costs of any cable box or satellite dish that is owned by the cable company

If an Illinois cable company has 100,000 cable subscribers located in Illinois and Indiana, then there are 100,000 income producing activities. It's likely that an Illinois cable company has greater than 50% of its direct costs in Illinois, including the cable subscribers adjacent to Illinois (depending on how much cable line the company owns out-of-state). In this case 100% of the cable revenues should be allocated to Illinois, except for any one-time hook-up fees on Indiana subscribers.

The same methodology applies to a cable company in Indiana that has subscribers in Illinois. Unless that company incurs greater than 50% of the cost in Illinois on some income producing activity, then none of the receipts would be allocated to Illinois.

On a hookup fee or other separately billed service that requires a visit to the subscriber's location by a technician, greater than 50% of the direct costs associated with that income will likely be in the state where the cable subscriber is located.

Example 5

Company A is a television station in Danville, IL which serves cable subscribers in Illinois and Indiana. Company A owns the lines and cable boxes to service each subscriber and has a satellite dish in Illinois to receive the signals from producers. The income producing activity of Company A is each receipt from advertising, each monthly cable fee, and each pay-per-view receipt. In 2007 Company A receives $10,000 from Company B to run TV ads produced both locally and in New York. If Company A is not unitary Company B, then all of the $10,000 is included in Company A's sales numerator. It is irrelevant where the ads were produced since third-party costs

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cannot be included in direct costs. If Company A is unitary with Company B, then the auditor will have to do a cost of performance test and include the direct costs of Company B in the 50% test. If the auditor determines that greater than 50% of the direct costs of both A and B are not in Illinois, then none of the $10,000 in receipts is included in the numerator.

Company A also receives $40 in monthly cable fees from each subscriber and occasionally receives $10 from subscribers for pay-per-view. The auditor determines that to service subscribers in Indiana direct costs are 70% in Illinois and 30% in Indiana (Indiana costs consist of line depreciation, line maintenance, and cable boxes). Since greater than 50% of the direct costs are in Illinois, Company A includes all of the monthly service fees in the numerator, including those from Indiana subscribers. For each $10 pay-per-view receipt, the taxpayer paid $8 for the programming. None of the $8 is included in the costs of performance test since it is an indirect expense paid to third parties. Therefore the cost of performance test is the same as for monthly subscribers.

Note: The answer is different for pay-per-view if the program were purchased from a non-Illinois unitary company as indicated in Example 6.

Example 6

Company A is a producer of television programs in New York. Company A incurs $70 million in direct costs (about 70% of its selling price) to produce a series of shows, and sells the right to broadcast the series for:

- $70 million to Company B, a wholesale distributor and a member of Company A's unitary group
- $30 million to Company D, an unaffiliated broadcast company

Company A's total sales are $100 million; however $70 million in sales are subject to an intercompany elimination

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on sales to Company B, so it reports $30 million in sales everywhere on its Illinois Schedule UB which consists only of sales to Company D. Company A's direct cost to produce the shows is about 70% of the selling price with the remaining 30% representing markup, executive salaries and administrative costs, which are not direct costs in computing costs of performance.

Company B, located in New York is a middleman and a distributor mostly for programming produced by Company A. Of its $70 million in purchases from Company A, it sells:

- $30 million to Company C, a broadcast company located in Illinois and a member of the unitary group
- $60 million to Company E, an unaffiliated broadcast company

On the Schedule UB Company B eliminates the $30 million in sales to Company C as an intercompany elimination.

Company C is a broadcasting company in Illinois. It purchased programs from the unitary group for $30 million and also purchases $30 million in programming from non-affiliated companies. Other costs include $50 million to operate the Illinois studio, generate an air signal and to service cable subscribers. For 2007 Company C has receipts of $160 million consisting of $100M in advertising income, $50M in monthly cable fees, and $10M in pay-per-view.

<u>Analysis</u>

On programming sold by Company A and B it is irrelevant where Companies C, D, and E are located. Company A and B have no numerator since there is no Illinois costs of performance.

In this example Company C has three types of income producing activities: the receipts from each advertiser for each ad, each monthly subscriber fee, and each pay-per-view receipt. On each of the receipts the direct costs would

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have to be greater than 50% in Illinois in order to include any of the receipts in the numerator. This will have to be determined on a test check basis. The auditor should contact CAA (Computer Assist Auditing) who will then work with the auditor to develop a statistical sample. Below are three items from the test check:

- $10,000 from Company Z, an unrelated advertising agency
- $40 from a cable subscriber in Illinois
- $10 from a pay-per-view subscriber

The majority of the direct cost for the $10,000 is likely to be the cost of the programming in which the ad was shown. If the ad was shown only during the programming purchased from Company B, then it's likely that greater than 50% of the costs of performance are in New York in which case none of the receipts would be included in the numerator. If the ad was shown while broadcasting local programming, or during programming purchased from non-affiliates, then it's likely that greater than 50% of the costs of performance are in Illinois. If the ad was run during a combination of programming, then some proration will be needed. It is irrelevant where the ad was produced or what Company Z's costs were in producing the advertisement.

The monthly cable fees will also be based on costs of performance. The direct costs for the 50% costs of performance test should be most of Company C's costs and the "direct costs" of programming purchased from Company B and Company C, since all of those costs are necessary to fulfill Company C's commitment to its subscribers. The $30M in programming paid to non-unitary third parties would not be included in the 50% test. The direct costs in Illinois for Company C's cable subscribers, less whatever direct cost are incurred in servicing non-Illinois cable subscribers (See Example 5) are as follows:

$50 million IL - Company C's direct costs

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$21 million NY - Company A's direct costs on programming ($30M x 70%)

$ 3 million NY - Company B's selling expenses ($30M x 10%)

Note that the actual computation of costs of performance would be on each income producing activity rather than aggregate numbers above.

On the pay-per-view receipts if the $10 receipt were received while broadcasting a program purchased from Company B, then none of the $10 is included in the numerator. If the $10 is received for a show purchased from a non-affiliated company, then all of the $10 will be included in the numerator. Although payments to non-affiliates are not included in the 50% test, greater than 50% of the direct costs should still be in Illinois.

7. ELECTRIC UTILITIES

The sales and distribution of electricity have historically been treated as the sale of service. As a result of the 2009 Illinois Supreme Court case of *Exelon v Department of Revenue*, the sale of electricity has been determined to be a sale of tangible personal property.

- For taxable years beginning after July 15, 2009, sales of electricity are sales of tangible personal property sourced under IITA § 304(a)(3)(B) based on Exelon Corp. v. Department of Revenue, 234 Ill 2d 266 (2009).

As tangible personal property, the sale of electricity is considered to be in Illinois if:

- The property is delivered to a purchaser, other than the U.S. government, within this state.
- The electricity is shipped from a place within this state and the purchaser is either the U.S. government or the person is not taxable in the purchasers state.
- The sale of electricity would not be in this state if the seller and purchaser would be excluded from being in the same unitary group due to one having

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80% or more business activity outside the U.S. and the property was for resale.

- For the taxable years ending after December 31, 2008 and prior to July 16, 2009 sales of electricity are sales of service sourced under IITA § 304(a)(3)(C-5)(iv).

Sales of service are in this State if:

- Gross receipts from the performance of services are attributed to the place the customer receives the service, unless the customer is a corporation, partnership or trust that has no fixed place of business in the state where the service is received.

- If the state of receipt is not readily determinable or the customer is a corporation, partnership or trust that does not have a fixed place of business in the state of receipt, the ordering location for these services, where the customer transacts its regular course of business will be used.

- If the ordering office cannot be determined, the services shall be deemed received at the customers billing address.

- If the taxpayer is not taxable in the state in which the services are received, the sale is excluded (thrown out) from the numerator and denominator of the sales factor.

For taxable years ending prior to December 31, 2008, sales of electricity are sales other than sales of tangible personal property sourced under IITA § 304(a)(3)(C).

a) Tax Years Ending Before December 31, 2008

Gross receipts from sales of electricity are in Illinois if the income-producing activity with respect to such sales is performed both within and without Illinois, but the greater proportion of such activity is within Illinois based on costs of performance. The income producing activities are the generation of electricity and transmission of such electricity to its consumers. Transmission costs are generally billed separately and therefore are a separate income producing activity.

If customers in Illinois are supplied electricity from generating plants both within and without, and if the greater amount of costs in operating those plants are out-of-state, then no Illinois sales would be attributed to the

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Illinois customers. However if the transmission costs are greater in Illinois than outside of Illinois, then Illinois will get 100% of the transmission receipts on those customers.

This analysis requires auditors to determine where the electricity is generated, at what cost, where and how the electricity is being transmitted, and at what costs. Likewise, it must be determined how much electricity the taxpayer is producing from out-of-state power plants. Simply "purchasing" the electricity from an out-of-state plant will not add to its "cost of performance" since the generation of electricity by a third party is not an "income producing activity" of the taxpayer.

b) Sales Flow-Through From Partnerships

For a brief overview, when corporations own an interest in a general or limited partnership they receive a federal Schedule K-1 from the partnership that shows the partner's share of various pass-through items of income, deductions and credits from the U.S. 1065. Ordinary income or loss reported on Schedule K-1, Part III, line 1 is normally included on the partner's U.S. 1120 line for other income or other deductions as a separate item, but the other separately stated items could be combined with other figures on the U.S. 1120.

If the partnership files an IL-1065 then it must send all of its partners an Illinois Schedule K-1-P Partner's or Shareholder's Share of Income, Deductions, Credits, and Recapture plus a Schedule K-1-P(2) Partner's and Shareholder's Instructions. Step 3 of the Schedule K-1-P reports each partner's share of nonbusiness income. Column A is for nonbusiness income everywhere and Column B is for the nonbusiness income allocable to Illinois. The determination of nonbusiness income is made at the partnership level. In Step 4 of the K-1-P the partnership reports each partner's share of business income. Column A is the partner's share of everywhere income from the federal K-1 and Column B are the business income amounts for each partner allocable to Illinois. Column B of the K-1-P is Column A times the partnership's Illinois apportionment factor.

If the partnership is unitary with its partners, then the partnership is required to attach a schedule to the Schedule K-1-P showing the partner's percentage share of sales everywhere and Illinois sales from Form 1065

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U.S. Return of Partnership Income. The partner then includes these sales in with its own sales when completing the IL-1120. If there are intercompany sales between the partnership and partner, see section on intercompany sales.

Note: There are no flow-through sales from S corporations to its shareholders. For further discussion and guidance on the treatment of partnerships and S-corporations refer to audit manual chapter 34 (new 28).

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V. EXHIBITS - HISTORICAL EXTRACTS

A. EXTRATERRITORIAL INCOME EXCLUSION

In 2000 Congress enacted IRC Section 114, which excluded extraterritorial income from gross income on the federal return and disallowed related federal deductions. Generally, the extraterritorial income exclusion applies to taxpayers with respect to transactions after September 30, 2000. The amount of the federal exclusion is calculated on Form 8873. This amount is then transferred to the U.S. 1120 and reported on the line for “Other deductions” or “Other expenses” and is identified as “Extraterritorial income exclusion from Form 8873”. Ref: Form 8873 Instructions.

The federal exclusion from gross income applies with respect to extraterritorial income, which is a taxpayer’s gross income attributable to foreign trading gross receipts. This income is eligible for the federal exclusion to the extent that it is “qualifying foreign trade income” (QFTI). QFTI is the amount of gross income that, if excluded, would result in a reduction of taxable income by the greatest of:

- 1.2% of the foreign trading gross receipts derived by the taxpayer from the transaction;
- 15% of the foreign trade income derived by the taxpayer from the transaction; or
- 30% of the foreign sale and leasing income derived by the taxpayer from the transaction.

In 2004, Congress repealed IRC Section 114, but included a phase-out provision that allowed an 80 percent exclusion of extraterritorial income for 2005 and 60 percent exclusion for 2006. The percentage exclusion is calculated on a transaction-by-transaction basis based on when the binding contract was made. Ref: Form 8873 Instructions.

How the federal exclusion is calculated for each year requires no special adjustment to Illinois base income since Illinois begins with federal taxable income. However an adjustment may be required to the sales factor, since income that is excluded from Illinois base income subject to apportionment is excluded from the sales factor under Regulation 100.3370(a)(2)(B) that states:

> "(2) The following gross receipts are not included in the sales factor."

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(B) "Gross receipts that are excluded from or deducted in the computation of federal taxable income or federal adjusted gross income, and that are not added back in the computation of base income..."

Therefore the sales factor does not include that amount of foreign trading gross receipts that is attributable to the taxpayer's excluded qualifying foreign trade income. The amount so attributable may be determined by multiplying the taxpayer's total foreign trading gross receipts by the percentage of the taxpayer's gross income from qualifying foreign trade property excluded from gross income under IRC section 114, or by applying the percentage of the taxpayer's foreign trade income treated as qualifying foreign trade income.

The Department explained this in Compliance Alert #2008-1. It can currently be found on the website (tax.Illinois.gov) in the section under Compliance Alerts, August 2007.

The Compliance Alert provides the following example:

Assume a taxpayer has the following scenario for its 2003 taxable year:

Foreign trading gross receipts	**$1,000**
(less) allocable cost of goods sold	$600
Total extraterritorial income	$400
Other allocable expenses	$100

- The taxpayer's Section 114 exclusion is the amount of its extraterritorial income that is qualifying foreign trade income.
- The taxpayer's qualifying foreign trade income is $60 (i.e., 15 percent of foreign trade income of $45 ($400 x 15%) grossed up for disallowed deductions of $15 ($100 x 15%)).
- Accordingly, the taxpayer must exclude from the numerator and denominator of its Illinois sales factor $150 or ($1,000 × $60/$400).

Note: The example from Compliance Alert #2008-1 says to exclude the $150 from the sales numerator and denominator. The $150 would be excluded from the numerator only to the extent that those sales were originally included in the numerator.

Since the example is for the year 2003, the exclusion is not subject to the 2005 and 2006 phase-out period. For 2005 and 2006 Form 8873 is essentially the same as for

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earlier years except for line 53 at the bottom of the second page that allows amounts subject to an exclusion of 60%, 80%, or 100% based on when the sale was made. The taxpayer could list amounts subject to all three percentages. Therefore the auditor will have to reduce the sales elimination based on the percentage of extraterritorial income actually excluded.

> For example, if the taxpayer is auditing 2005 or 2006 and the normal sales exclusion based on the Alert Bulletin is $100,000, but the taxpayer has amounts on Form 8873, page 2, line 53 that allow an average 83% phase-out exclusion, then the auditor will exclude $83,000 from the sales everywhere factor.

The Department prefers that the sales factor exclusion be based upon the example in Compliance Alert 2008-1 above since that is the formula that would be used to defend the audit adjustments in administrative hearings and in the courts. The auditor will have to request the information from the taxpayer on an EDA-70 rather than rely upon the figures on Form 8873.

> Note: Federal Form 8903 has replaced Form 8873. Form 8903 is for the domestic production activities deduction, not the extraterritorial income exclusion. Although similar to Form 8873, the Department will not make any adjustments to the sales factor for Form 8903.

B. ROYALTY TEST – EXHIBITS

Example 1

Company A is determining whether to include B-2 receipts in its sales factor for 1999. In calendar year 1999, Company A reports the following amounts on its federal return –

	1999
Royalties (patents)	$20,000,000
Gains on sale of patents	
Rcpts from sale of patents	
Total B-2 receipts	$20,000,000
Total gross receipts	$700,000,000
B-2 percentage	3%

Since the B-2 receipts do not exceed total gross receipts for the current year, it is unnecessary to perform the test on one or both of the prior tax years. The $20,000,000 in royalties will be excluded from Company A's 1999 sales factor.

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Example 2

Company B is determining whether to include B-2 receipts in its sales factor for 1999. In calendar years 1997, 1998 and 1999, Company B reports the following amounts on its federal return –

	1997	1998	1999
Royalties (patents)	$80,000,000	$60,000,000	$20,000,000
Gains on sale of patents		$20,000,000	$22,000,000
Rcpts from sale of patents		$250,000,000	$350,000,000
Total B-2 receipts	$80,000,000	$310,000,000	$370,000,000
Total gross receipts	$500,000,000	$600,000,000	$700,000,000
B-2 percentage	16%	52%	53%

The B-2 receipts would not be included in the sales factor for 1999 because, although they exceed 50% of the total gross receipts in 1998 and 1999, they do not exceed 50% of total gross receipts for 1997.

If an entity is not in existence for either one or more of the 2 preceding tax years, the test will be applied on as many years as the taxpayer is in existence.

Example 3

Company C is determining whether to include B-2 receipts in its sales factor denominator for 1999. Company C was incorporated on January 1, 1998. In calendar years 1998 and 1999, Company C reports the following amounts on its federal return -

	1998	1999
Royalties (patents)	$60,000	$70,000
Gains on sale of patents		
Rcpts from sale of patents		
Total receipts B-2	$60,000	$70,000
Total gross receipts	$100,000	$100,000
B-2 percentage	60%	70%

Since Company C has only been in existence for the current year and the one preceding tax year, the 50% of total gross receipts test is conducted on these two years. Company C's B-2 receipts exceed its total gross receipts for the current year and the previous year, so C will include the B-2 receipts in its sales factor in 1999.

If a person is a member of a unitary business group, the test is performed using the total gross receipts of the entire unitary business group as the denominator and the B-2

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receipts of the entire unitary business group as the numerator. Gross receipts from transactions between members of the unitary group are eliminated from both the numerator and denominator of the computation.

At times, the unitary group membership may change during the test period. If it is necessary to compare gross receipts for the preceding years, the comparison will be made using the gross receipts and B-2 receipts for the same companies that comprise the unitary group for the current year.

Example 4

In 1999, a unitary group is comprised of companies A, B, C, and D. In computing ABCD's sales factor, the B-2 gross receipts test is performed. B-2 receipts exceed 50% of total gross receipts for ABCD for 1999. Therefore, the test must also be performed on 1998.

In 1998, the unitary group is comprised of ABC and company E. Company D was an unrelated company for 1998 and was not purchased until 1/1/99. Company E was sold on 12/31/98. B-2 receipts for ABC and D will be compared to total gross receipts of ABC and D for 1998. If the B-2 receipts do not exceed 50% of gross receipts, ABCD will not include B-2 receipts in its sales factor for 1999. If the B-2 receipts exceed 50% of gross receipts for 1998, the test must be performed on 1997, again using the receipts of A, B, C, and D.

Note: PA 91-541 allowed the taxpayer to make an election to exclude B-2 receipts for tax years prior to December 31, 1999. If the election was made, the taxpayer could not receive a refund but could offset the liability from an Illinois audit or a federal RAR.

C. CATEGORIZING COMPUTER SOFTWARE EXAMPLES

Federal Treasury Regulations § 1.861-18 provide eighteen examples illustrating the categorization of transactions to various fact patterns. The auditor may consult these examples for further guidance. Four of those examples are considered below.

Example 1

(i) Facts. Corp A, a U.S. corporation, owns the copyright in a computer program, Program X. It copies Program X onto disks. The disks are placed in boxes covered with a wrapper on which is printed what is generally referred to as a shrink-wrap license. The license is stated to be perpetual. Under the license no reverse engineering, decompilation, or disassembly of the computer program is permitted. The transferee receives, first, the right to use the program on two of its own computers (for example, a

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laptop and a desktop) provided that only one copy is in use at any one time, and second, the right to make one copy of the program on each machine as an essential step in the utilization of the program. The transferee is permitted by the shrink-wrap license to sell the copy so long as it destroys any other copies it has made and imposes the same terms and conditions of the license on the purchaser of its copy. These disks are made available for sale to the general public in Country Z. In return for valuable consideration, P, a Country Z resident, receives one such disk. (ii) Analysis. (A) Under paragraph (g)(1) of this section, the label license is not determinative. None of the copyright rights described in paragraph (c)(2) of this section have been transferred in this transaction. P has received a copy of the program, however, and, therefore, under paragraph (c)(1)(ii) of this section, P has acquired solely a copyrighted article. (B) Taking into account all the facts and circumstances, P is properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been a sale of a copyrighted article rather than the grant of a lease.

Because the transaction is categorized federally as the transfer of a copy of a computer program (a copyrighted article), for sales factor purposes Corp A has gross receipts from intangible personal property under IITA Section 304(a)(3)(C-5)(iii). Under the facts of the example, Corporation A would be considered a "dealer" within the meaning of IRC Section 475. Therefore, the transaction would not be considered a sale in Illinois.

Example 8

(i) Facts. Corp A, a U.S. corporation, transfers a disk containing Program X to Corp D, a foreign corporation engaged in the manufacture and sale of personal computers in Country Z. Corp A grants D the non-exclusive right to copy program X onto the hard drive of an unlimited number of computers, which Corp D manufactures, and to distribute those copies (on the hard drive) to the public. The term of the agreement is 2 years, which is less than the remaining life of the copyright in Program X. Corp D pays Corp A an amount based on the number of copies of Program X it loads on to computers. (ii) Under paragraph (c)(2)(i) of this section, Corp D has acquired a copyright right enabling it to exploit Program X by copying it on to the hard drives of the computers it manufactures and then sells. For purposes of paragraph (b)(2) of this section, the disk containing program X is a de minimis component of the transaction. Taking into account all of the facts and circumstances, Corp D has not, however, acquired all substantial rights in the copyright to Program X (for example, the term of the agreement is less than the remaining life of the copyright). Under paragraph (f)(1) of this section, this transaction is, therefore, a license of Program X to Corp D rather than a sale and the payments made by Corp D are royalties. (The result would be the same if Corp D included with the computers it sells an archival copy of Program X on a floppy disk.)

Because the transaction is classified federally as the transfer of a copyright right in a computer program, for sales factor purposes Corp A has gross

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receipts from the license, sale, or other disposition of a copyright under IITA Section 304(a)(3)(B-1). Assuming that more than 50% of Corp A's gross receipts are from such items, gross receipts would be assigned to Country Z, the place where D's use of the copyright originates.

Example 15

(i) Facts. Corp H, a country Z corporation, enters into a license agreement for a new computer program. Program Q is to be written by Corp A, a U.S. corporation. Corp A and Corp H agree that Corp A is writing Program Q for Corp H and that, when Program Q is completed, the copyright in Program Q will belong to Corp H. Corp H gives instructions to Corp A programmers regarding program specifications. Corp H agrees to pay Corp A a fixed monthly sum during development of the program. If Corp H is dissatisfied with the development of the program, it may cancel the contract at the end of any month. In the event of termination, Corp A will retain all payments, while any procedures, techniques or copyrightable interests will be the property of Corp H. All of the payments are labeled royalties. There is no provision in the agreement for any continuing relationship between Corp A and Corp H, such as the furnishing of updates of the program, after completion of the modification work. (ii) Analysis. Taking into account all of the facts and circumstances, Corp A is treated as providing services to Corp H. Under paragraph (d) of this Section, Corp A is treated as providing services to Corp H because Corp bears all of the risks of loss associated with the development of Program Q and is the owner of all copyright rights in Program Q. Under paragraph (g)(1) of this section, the fact that the agreement is labeled a license is not controlling (nor is the fact that Corp A receives a sum labeled a royalty).H

Because the transaction is classified federally as the provision of services for the development or modification of a computer program, for sales factor purposes Corp A has gross receipts from sales of service under IITA Section 304(a)(3)(C-5)(iv).

Example 16

(i) Facts. Corp A, a U.S. corporation, and Corp I, a Country Z corporation, agree that a development engineer employed by Corp A will travel to Country Z to provide know-how relating to certain techniques not generally known to computer programmers, which will enable Corp I to more efficiently create computer programs. These techniques represent the product of experience gained by Corp A from working on many computer programming projects, and are furnished to Corp I under nondisclosure conditions. Such information is property subject to trade secret protection. (ii) Analysis. This transaction contains the elements of know-how specified in paragraph (e) of this section. Therefore, this transaction will be treated as the provision of know-how.

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Because the transaction is classified federally as the transfer of know-how, for sales factor purposes Corp A has gross receipts from the license, sale, or other disposition of a patent, copyright, trademark or similar item of intangible personal property under IITA Section 304(a)(3)(B-1). Assuming that more than 50% of Corp A's gross receipts are from such items, gross receipts from the transaction would be assigned to the commercial domicile of Corp I.

D. SALES OF SERVICE

Sales of Service - Tax years ending before December 31, 2008

For transactions other than the sale of intangible personal property and receipts from patents, copyrights and trademarks (royalties), for tax years ending before December 31, 2008 sales are in this state under IITA § 304(c)(3)(C) if:

(i) The income-producing activity is performed in this State

(ii) The income-producing activity is performed both within and without this State and a greater proportion of the income-producing activity is performed within this State than without this State, based on cost of performance.

Therefore if "a greater proportion" (over 50%) of the income producing activity occurs in Illinois, then all of the receipts will be included in the Illinois sales numerator. However, if less than 50% of the income producing activity occurs in Illinois, then none of the receipts are included in the sales numerator. Consequently all receipts from intangibles, other than from royalty income, will be allocated based on a 50% cost of performance test.

The first step in applying the 50% test is to identify the "income producing activity". Income producing activity is defined in IAC § 100.3370(c)(3)(A) and applies to each separate item of income activity directly engaged in for profit in a person's regular trade or business.

The intent of the regulation is to measure the income producing activity by each individual transaction rather than a group of transactions. See section below on Income Producing Activity.

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The second step in determining the 50% test is to measure the "cost of performance". This is defined in IAC § 100.3370(c)(3)(B).

Once the income-producing activity has been identified, the cost of performance can be measured based on the "direct costs" for that activity. Third-party costs including costs incurred by independent contracts are not direct costs. Once the direct costs have been identified, each individual sale of service must be analyzed in order to determine where the greater costs are performed. If greater than 50% of the "direct costs" are in Illinois, then 100% of the sales of service on that specific sale would be allocated to Illinois. This process can be done on a test check basis. See sections below on Income Producing Activity and Cost of Performance.

1. COST OF PERFORMANCE

For tax years ending prior to December 31, 2008 all receipts that fall under IITA § 304(a)(3) that are not receipts from the sales of tangible personal property, or receipts from patents, copyrights, and trademarks are apportioned under Section 304(a)(3)(C)(i)&(ii). That states that receipts, other than receipts governed by paragraphs (B) and (B-1), are in this State if:

(i) The income-producing activity is performed in this State; or

(ii) The income-producing activity is performed both within and without this State and a greater proportion of the income-producing activity is performed within this State than without this State, based on performance costs.

For sales of real property and rental or leasing of real or tangible personal property, the income-producing activity centers around the property, and so the receipts are sourced to the location of the property. Rental income from tangible personal property used in multiple states is prorated by time of use.

For tax years ending on or after December 31, 2008, the cost of performance test applies only to income from intangibles realized by taxpayers who are not dealers in that property. In that case, all of the receipts will be included in the Illinois sales numerator if the cost of performance in Illinois is greater than any other single state, even if the percentage is under 50%.

Example

In 2007 the taxpayer receives a contract to design a custom software package. The order is received from an office in Illinois. In order to complete the contract

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the taxpayer incurred direct costs of performance of 40% in Illinois, 30% in Florida and 30% in Indiana. Under the provision in Section 304(a)(3)(C)(ii) a sale is included in the Illinois sales numerator only if the costs of performance within Illinois are greater than the costs of performance outside Illinois. In this example none of the receipts would be allocated to Illinois because less than 50% of the costs of performance were incurred in Illinois.

a) Income Producing Activity

IAC § 100.3370(c)(3)(A) provides the definition of what constitutes income producing activity under the IITA:

- Transactions and activity directly engaged in by the person in the regular trade or business, for the purpose of making a profit.
- It applies to each separate item of income.
- It does not include transactions and activities performed on behalf of a person like an independent contractor.

The regulation refers to **"**each separate item of income**".** The intent is to measure the income producing activity by each individual transaction rather than groups of transactions. Taxpayers will often argue that each separate item of income means each individual sales account number in their books and records thereby bringing in direct costs from all of the states that the taxpayer does business, but this was never the intent of the regulation.

Examples of income producing activities:

- Telecommunications: each individual call or data transmission
- Stock broker: individual stock transactions
- Broadcast company: each individual broadcast or cable fee receipt

b) Direct Costs

Costs of performance are defined as "direct costs" consistent with generally accepted accounting principles (GAAP), which is a set of accounting and financial reporting standards administered by the Financial Accounting Standards Board (FASB).

A "direct cost" of a service is a cost that is incurred only in the provision of a particular service, in comparison to an "indirect cost" that is incurred in support of more than one activity. A direct cost, then, is a cost that is

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incurred only in connection with one activity, and is therefore attributable entirely to that activity. The most important aspect to identifying direct vs. indirect costs is defining the activity.

Example: The labor of an employee in providing the service and materials actually consumed in providing the service are direct costs. The time spent by a company president supervising the general affairs of the business, on the other hand, even when it is attributable in part to service provided, would be an indirect cost.

Example: A stock broker/dealer operates in Chicago and New York. The income producing activity is the individual stock transactions. Direct costs are:

- Compensation to traders;
- Compensation to runners and assistants to floor traders;
- Compensation to processing clerks;
- Compensation to management and support employees for activities directly related to a sale;
- Seat Leases;
- Rent expense allocable to office space used in an activity directly related to a sale;
- Depreciation on office equipment attributable to its use in activities directly connected to a sale,
- Communication and data processing costs incurred in connection with a sale;
- Travel and airline costs for employees traveling in connection with a particular sale

(1) Costs That Do Not Qualify As Direct Costs:

- Compensation to management and support employees for activities that are not related to a particular sale are not direct costs;
- Rent expense allocable to office space used in support activities, rather than in connection with an activity directly related to a sale;
- Payments to third-party clearing brokers and floor brokers and “payments for order flow” to third-party brokers.

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c) Contracts

Some taxpayers have signed contracts to perform services over a period of years, then collect monthly payments for the services provided. The original contract will show what the different income producing activities are. The income producing activity will be determined separately for each separate sale of service. The taxpayer must have backup documentation for each contract that would show a breakdown of the estimated costs to perform that contract. The taxpayer must have some assurance before it enters into the contract that it is not going to lose money over the life of the contract. This would be the same as a construction contractor developing a bid sheet that would show the construction materials, cost of labor, rent or lease of equipment, etc. All of this backup documentation should be examined.

E. PROPERTY AND PAYROLL FACTORS

1. THE ELIMINATION OF PROPERTY AND PAYROLL 1998-2000

Prior to the tax year ending December 31, 1998, Illinois had relied upon a three factor apportionment formula of property, payroll and sales. In 1998 the Department began phasing out the property and payroll factors over a three year period, leaving a single sales factor in the third year. For tax years ending on or after December 31, 2000, only sales are used in Illinois to figure the apportionment factor.

Refer to the form instructions for each year on the Department web site and review the proper factor weighting for those tax years affected. Instructions are on the Departments web site under forms, prior years, and the specific year in question. For tax years ending December 31, 1998, and December 31, 1999 property and payroll weighting was reduced by the following:

Tax Years Ending On or After December 31, 1998 - 16 2/3% of the property factor, 16 2/3% of the payroll factor plus 66 2/3% of the sales factor. (See Example 1)

Tax Years Ending On or After December 31, 1999 - 8 1/3% of the property factor, 8 1/3% of the payroll factor plus 83 1/3% of the sales factor. (See Example 2)

Tax Years Ending On or After December 31, 2000 - 100% the sales factor.

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Example 1 - Tax Years Ending On or After 12/31/1998 (Public Act 90-615)

	Factors	Times %	Factors
	Before PA		After PA
Property Factor	30.0000%	16.6667%	5.0000%
Payroll Factor	50.0000%	16.6667%	8.3333%
Sales Factor	10.0000%	66.6666%	6.6667%
Sales Factor	10.0000%	0	0.0000%
Total Factors	100.0000%		20.0000%
Divided by	4		
Apportionment Factor	25.0000%		20.0000%

Example 2 - Tax Years Ending On or After 12/31/1999 (Public Act 90-615)

	Factors	Times %	Factors
	Before PA		After PA
Property Factor	30.0000%	8.3333%	2.5000%
Payroll Factor	50.0000%	8.3333%	4.1667%
Sales Factor	10.0000%	66.6666%	6.6667%
Sales Factor	10.0000%	0	0.0000%
Total Factors	100.0000%		20.0000%
Divided by	4		
Apportionment Factor	25.0000%		15.0000%

2. PROPERTY AND PAYROLL FACTORS IITA § 304(a) PRE 12-31-00

Auditors may need to reference these factors for information under several instances:

- In the event an audit is required on years prior to 2000.
- In the question of whether nexus may be present for a company, as reference.
- In the situation where a petition for alternative apportionment is filed under IITA Section 304(f) and an additional factor may be presented.
- In the computation of the 80/20 calculation for foreign taxpayers

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a) Property Factor

The property factor is addressed under IITA Section 304(a)(1) and in IAC §100.3350. There have been no amendments to the property factor provisions of the Act since 1969.

IITA § 304(a)(1) provides that the property factor used in apportioning business income is a fraction. The numerator is the average value of real and tangible personal property owned or rented and used in the trade or business of the taxpayer in Illinois during the taxable year. The denominator is the average value of all of the person's real and tangible personal property owned or rented and used in the trade or business during the taxable year.

What this fraction attempts to reflect is the percentage value that the Illinois property contributed to the earning of business income. Several words and phrases in this statutory definition should be expanded upon.

1. "Real and tangible personal property." This includes land, buildings, machinery, equipment, inventories, stocks of goods, livestock, poultry, and growing crops, as well as all other real and tangible personal property used in the production of business income. It does not include coin or currency.

2. "Used in the trade or business." In order to be included in the property factor the property in question must be used to derive business income.
   If property is used to derive both business and nonbusiness income, the components of the property relating to the generating of business income should be included in the factor while the nonbusiness income components should be excluded.

3. “Value” means the original cost of the property owned by the taxpayer, without reduction for depreciation or amortization, or, in the case of property rented by the taxpayer for use in its trade or business, 8 times the net annual rent for the property.

4. "Average value." This is normally determined by adding the values of all the aforementioned property at the beginning of the tax year and at the end of the tax year. The sum of, which is divided by two (2). However, if significant fluctuations in the value of the property exist between the beginning or ending of a tax period, monthly values should generally be analyzed and an average obtained. Additionally, if significant amounts of property are acquired or disposed of during

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the year, then monthly values would be applied. REF: IAC §100.3350(g).

EXAMPLE 1

The beginning and ending values of property as reported on the Balance Sheet of a federal 1120 of a calendar year taxpayer in the business of operating a number of office supplies, retailer locations were as follows:

	1/1/20--	12/31/20--
Inventories	$1,000,000	$1,100,000
Land	$4,000,000	$4,000,000
Fixed Assets	$9,500,000	$9,600,000
TOTALS	$14,500,000	$14,900,000

A review of the applicable General Ledger Accounts determined that no significant fluctuations existed between the beginning and end of the year or between any given months.

The average property would be computed as follows:

$14,500,000 + $14,900,000 = $29,400,000
$29,400,000 divided by 2 = $14,700,000 = AVERAGE PROPERTY

EXAMPLE 2

The beginning and ending values of property as reported on the Balance Sheet of the Federal 1120 of a calendar year ending taxpayer operating a number of ice cream wholesalers were as follows:

	1/1/20--	12/31/20--
Inventories	$1,000,000	$1,100,000
Land	$4,000,000	$4,200,000
Fixed Assets	$9,500,000	$9,600,000
TOTALS	$14,500,000	$14,900,000

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A review of the Monthly Inventory Accounts of the taxpayer revealed the following information:

Jan	$1,000,000	Jul	$7,500,000
Feb	$1,010,000	Aug	$8,800,000
Mar	$1,005,000	Sep	$2,000,000
Apr	$1,100,000	Oct	$800,000
May	$4,000,000	Nov	$810,000
Jun	$6,800,000	Dec	$1,100,000
		TOTAL	$35,925,000

A review of the Land and Fixed Asset Accounts of the taxpayer did not reveal any fluctuations in the values throughout the year. Therefore the values were obtained from the balance sheet as follows:

	1/1/20--	**12/31/20--**
Land	$4,000,000	$4,200,000
Fixed Assets	$9,500,000	$9,600,000
TOTALS	$13,500,000	$13,800,000

In this situation, the average property would be computed as follows:

INVENTORIES: $35,925,000 divided by 12 months	= $ 2,993,750
LAND & F/A $13,500,000 + $13,800,000	= $27,300,000
$27,300,000 divided by 2	= $13,650,000

AVERAGE INVENTORIES	= $ 2,993,750
AVERAGE LAND & F/A	= $13,650,000
AVERAGE PROPERTY	= $16,643,750

EXAMPLE 3

For illustrative purposes, assume that the facts remain the same as in EXAMPLE 2 above except that the ending balance in the fixed asset account amounted to $33,600,000. A review of the appropriate General Ledger account noted that several new production lines were purchased on April 1st.

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The average property would be computed as follows:

- INVENTORIES: $35,925,000 divided by 12 months = $2,993,750

	1/1/20--	12/31/20--
• Land	$ 4,000,000	$ 4,200,000

  - AVERAGE LAND = $4,000,000 + $4,200,000 = $8,200,000
    $8,200,000 divided by 2
    = $4,100,000

FIXED ASSETS

The average Fixed Asset computation would be computed as follows:

STEP #1

	1/1/20--	12/31/20--
Fixed Assets	$9,500,000	$33,600,000

$ 9,500,000 + $33,600,000 = $43,100,000
$43,100,000 divided by 2 = $21,550,000 = SUB TOTAL

STEP #2:

A $24,000,000 purchase of assets is represented in the ending fixed asset values. Therefore, 50% of this value is taken into consideration in STEP #1 above. However, as the assets were acquired April 1st, 75.34 % of this value should be represented as follows:

Jan	**$9,500,000**	**Jul**	**$33,600,000**
Feb	$9,500,000	Aug	$33,600,000
Mar	$9,500,000	Sep	$33,600,000
Apr	$33,600,000	Oct	$33,600,000
May	$33,600,000	Nov	$33,600,000
Jun	$33,600,000	Dec	$33,600,000
		TOTAL	$330,900,000

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The average fixed asset value would therefore be:
$330,900,000 divided by 12 months = $27,575,000

(1) Schedule VI-A For Adjustments For Fluctuating Inventory/Assets

This schedule was used to assist auditors in the calculation of inventory when large fluctuations occurred during the course of a taxable year. Basically this was a spread sheet program. This tool was kept on the auditor's computer to create a month to month schedule in order to obtain the average value of inventory as property for the taxable year. As a general rule, this form was used if the amount of change had a 40% fluctuation (either plus or minus) during the audit period. The same information can be ascertained by creating a spread sheet to calculate the average monthly inventory for property valuation.

(2) Schedule VI-A For Fluctuating Assets

This schedule was used to assist auditors in the calculation of assets when purchases or dispositions of assets occurred during the course of a taxable year. Basically this was a spread sheet program. This tool was kept on the auditor's computer to obtain the average value of assets as property for the taxable year, to ensure that part year assets were added into the value of whole year assets.

The number of days the acquired or sold asset was held was divided by the number of days in the year multiplied by the acquisition cost of the asset. In this manner, the property value of the asset was not over or under valued. Another type of adjustment was allowed in the case an assets value fluctuated (the impairment or capitalized improvement of an asset). As with obtaining the valuation for fluctuating inventory, a spreadsheet can be created to correctly obtain the average asset value for the year.

(3) Valuation of Owned Property

IITA § 304(a)(1)(B) and IAC § 100.3350(e)- Valuation of owned property is valued:

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- at the original acquisition cost of purchase,
- without federal adjustments afterwards like depreciation, depletion, or amortization,
- by adding capital improvements to the acquisition cost, and;
- by subtracting any partial dispositions through sale, exchange or abandonment.

The use of original cost is an authoritative rule to be complied with, rather than an area of departmental discretion. The use of original cost to value property is consistent with both UDITPA and the Multistate Tax Commission. The use of original cost obviates any differences due to varying methods of depreciation, and has the advantage that the basic figure is readily ascertainable from the taxpayer's books.

(a) Cost Sources of Original Owned Property

The following are items to be considered in verifying original cost:

i. The use of the annual report & the US 1120 returns to test the denominator of the property factor are the quickest methods to use. If annual reports are not available, year-end trial balances or CPA audited balance sheets provide a satisfactory source for verifying owned property.

ii. The depreciation schedule per the US 1120 shows property at the federal tax basis. If the balance sheet amounts vary significantly from the cost as shown for depreciation purposes, the balance sheets may not be on a federal tax basis or other differences such as construction-in-progress may be included.

For more information regarding construction-in-progress refer to the (Construction-In-Progress) section.

iii. The property ledger may be used for the reconciliation or verification of the differences if material. For example, fully depreciated property may not appear on the US 1120 balance sheet however it should still be included in the property factor if it is still used in the production of business income.

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iv. If the taxpayer reports its foreign subsidiaries' inventory at a different cost basis for book purposes but adjusted to the parent's basis for determining the unitary business income, the adjusted amount should be reflected in the denominator. This would only apply to foreign subsidiaries that perform in excess of 20% of their business activities within the United States and, therefore, are included in the unitary business group.

(4) Capitalized Interest

Capitalized interest payments should be included in the property factor only if it is included in the original federal income tax basis of the property or the basis of some improvement to the property.

(5) Unbilled Contract Costs on Long Term Contracts

This issue came up in an administrative hearing case on [redacted], a manufacturer of specialized communications and information systems that sold many of its products under long-term contracts. Under a fixed price contract, unbilled costs are not recoverable under the terms of the contract. These costs must be separately disclosed on the financial statements in accordance with Generally Accepted Accounting Principles (GAAP). The taxpayer claimed that these unbilled costs are much the same as inventory.

The Department held the opinion that unbilled contract costs should not be considered "inventoriable goods in process" because the expenses are deducted in the year incurred to arrive at federal taxable income. Therefore they should **not** be accumulated as inventory and therefore should be excluded from the property factor.

The Department then lost the administrative hearing decision on [redacted], when the ALJ ruled that [redacted] unbilled costs come within the definition of property to be included in the property factor". However, the Department still takes the position unbilled contract costs **should not** be included in the property factor. The Departments position is set forth below.

> Although we must follow the Hearings decision, the Department is not required to include any balance in an "Unbilled Cost Account" in the property factor because its "value" for property factor purposes is $0 under IAC § 100.3350(e). IAC §100.3350(e) states that the value of

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property for property factor purposes is as follows: property owned by the person shall be valued at its original costs.

- original cost is the basis of property for federal income tax purposes at the time of acquisition
- original cost does not reflect subsequent federal adjustments afterwards like depreciation, depletion, or amortization

However, original cost will include the cost at acquisition, any capital improvements and any partial dispositions through sale, exchange or abandonment.

The property that relates to the taxpayer's Unbilled Cost Account has a basis for federal income purposes at acquisition of $0 because the costs of the contract are immediately expensed for income tax purposes. As the taxpayer recognizes revenue from the contract, that recognition results in the taxpayer having a basis in the long-term contract, not the underlying property. Subsequent gain or loss is recognized on the contract.

And even if the taxpayer could be considered to have a basis at acquisition, the valuation would have to be decreased to $0 under IAC §100.3350(e)(1) because the percentage of the property completed has been disposed of for tax purposes.

The Hearings decision did not determine the valuation issue, and thus the Department may apply the regulations by valuing the Unbilled Cost Account at $0.

(6) Valuation of Rented Property

The inclusion of rents in the property factor is addressed under IAC § 100.3350(f).

Rented property used to generate business income is included in the property factor at 8 times the annual rental rate. The annual rental rate is generally the rent expense paid less the aggregate annual sub-rents paid by the tenants of the person.

Several words and phrases in the statutory definition should be expanded upon.

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1. "Annual Rental Rate." This is the amount paid as rent for the property in a 12-month period. Where property is rented for less than a 12-month period, the rent paid for the actual period of rental shall constitute the "annual rental rate" for the period. In the case of a short year, the rent expense may be adjusted to cover a 12-month period to show a fair value of rented property. REF: IAC §100.3350(f)(2).

EXAMPLE 1

Corporation A rented property with an 8-month lease. The monthly lease payment amounted to $2,500. The annual rental rate would be computed as follows:

$2,500 multiplied by 8 months = $20,000

EXAMPLE 2

Corporation A, which ordinarily files its returns based on a calendar year, is merged into Corporation B on April 30th. The net monthly rent paid on a 5-year lease with 3 remaining years is $2,500 a month. The rent expense for the period January 1st to April 30th is $10,000. The annual rental rate would be computed as follows:

$2,500 multiplied by 12 months = $30,000

In Example 2 the monthly rent is annualized since the corporation has rented the property for a period of more than 12 months even though the current tax period covers a period of less than 12 months.

2. "Aggregate annual sub-rents paid by sub-tenants." Where a taxpayer leases property and then, in turn, sub-leases this property (or a portion of this property) to sub-tenants, the annual sub-rents received should be subtracted from the annual rent expense.

However, if these sub-rents constitute business income, due to the property, which produces these sub-rents being used in the regular course of the trade or business, then these sub-rents SHOULD NOT be subtracted from the rent expense. (IAC §100.3350(f)(1))

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EXAMPLE 1

Corporation A rents a food market. A receives sub-rents from a bakery concession in the food market. Since the sub-rents are business income they SHOULD NOT be deducted from the rents paid A for the food market

EXAMPLE 2

Corporation C rents a 20-story office building and uses the lower 2 floors for it's general corporate headquarters. The remaining 18 floors are subleased to others. The rental of the other 18 floors is separate from the operation of C's trade or business. Since these sub-rents are nonbusiness income they should be subtracted from the rent expense paid by C.

The reasoning behind subtracting nonbusiness income sub-rents is consistent with the position that components of nonbusiness income should not be included in the factors when apportioning business income. This is accomplished by subtracting the (nonbusiness income) sub-rents from the rent expense.

3. "Annual rent." This is the actual sum of money or other consideration payable, directly or indirectly, by the person or for its benefit for the use of the property. Other consideration would include any amounts payable as a percentage of sales, profits, or otherwise.

EXAMPLE 1

Corporation A, pursuant to the terms of the lease, pays a lessor $1,000 per month as a base rental and at the end of the year pays the lessor 2.5 % of the gross profit. At the end of the year Corporation A had $1,000,000 in gross profit.

The annual rent would be computed as follows:

$1,000 multiplied by 12 months	=	$12,000
$1,000,000 multiplied by 2.5 %	=	$25,000
Total Annual Rent		$37,000

Other consideration would also include any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance, repairs, or any other items which are required to be paid by the terms of the lease or other arrangement. This

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would not include amounts paid as service charges, such as utilities, janitor services, etc.

EXAMPLE 2

Corporation A, in accordance with the terms of a lease, agrees to pay the lessor $12,000 a year rent plus taxes in the amount of $8,000 and interest on a note in the amount of $2,000.

The annual rental would be computed as follows:

12,000 + 8,000 + 2,000 = $22,000

4. Annual rental does not include incidental day-to-day expenses such as hotel accommodations or daily rental of autos. Ref: IAC § 100.3350(f)(3)(C).

5. Rent Includes Royalties on Natural Resources. IAC §100.3350(f)(3) was amended on 8/23/2002 to add subparagraph (C). Subparagraph (C) provides guidance for annual rent and what is to be included in calculating this amount. Annual rent is to include royalties based on extraction of natural resources, delivered or purchased. For this purpose, a royalty includes any consideration or credit conveyed to the holder of an interest in property which is, or will be producing natural resources. It doesn't matter how the payment is characterized; as rent, royalty, advance royalty, or otherwise.

(7) Free Use of Facilities

If a taxpayer uses tangible property or rental property for free or property for which only a nominal fee is paid, a fair market value of this property should be established. The fair market value of this property should be included in the property factor computation. REF: IAC §100.3380(b)(2).

At times a parent corporation may be renting facilities to an affiliated company. The rent expense may be hidden in an account called management fees. This account can be a "catch-all" account where a parent corporation charges the affiliate fees for administrative functions performed on the affiliate's behalf by the parent. An

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examination of this account may be beneficial in developing the property factor.

(8) Construction In-Progress

Property or equipment that is under construction during the year is excluded from the factor until such time that the property or equipment is used in the regular course of the trade or business. If the property or equipment does not appear in the depreciable assets or on the depreciation schedule, it will appear as a separate entry on the balance sheet. (IAC § 100.3350(b))

The reasoning behind excluding construction-in-progress from the property factor hinges on the IITA definition that the property must be "used in the trade or business". If the property in question is being constructed it is not being used and accordingly is not generating business income. It should, therefore, not be included in the property factor.

(9) Property in Transit

Property in transit is discussed in IAC § 100.3350(d). When property is in transit between locations of the person who owns the property, the property in question shall be considered to be at its destination for purposes of the property factor.
Example:

Corporation A manufactures cabinets in California. After these cabinets are completed, they are shipped to A's warehouse in Illinois. At the end of A's tax year, $5,000,000 of these cabinets are in transit between the California manufacturing location and the Illinois warehouse. Since the final destination is Illinois, the cabinets should be included in the numerator as Illinois inventory.

When property is in transit between a buyer and seller and, in accordance with its regular accounting procedures, the seller includes the property in the denominator of the property factor, then the property in question should be included in the numerator based on the state of destination of the property. It should be noted however, that a taxpayer would not have a property factor in Illinois if the protection offered by PL 86-272 has not been forfeited.

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EXAMPLE 1

Corporation A has a manufacturing location in California and sales offices in Illinois. At the close of A's tax year $5,000,000 in goods are in transit between A's manufacturing location in California and A's customer in Illinois. A's accounting procedures are such that these goods in transit are included in the denominator of the property factor. As such, these goods should be included in the numerator, as Illinois inventory.

EXAMPLE 2

Assume the same facts as in Example 1 except that A does not have a sales office in Illinois. Furthermore, A has no other presence in Illinois and its activities in Illinois have not exceeded those permitted under PL 86-272. In this situation the goods in transit would not be included in the numerator of A's property factor.

The above regulations allow taxpayers limited flexibility in determining what inventory to include in the property factor. To take advantage of the tax savings opportunity allowed by this flexibility in determining the composition of the property factor, companies may review in-transit inventory when it comes on the books. A determination may be made to include or exclude this in-transit inventory from the factor depending on how it affects the overall tax liability.

It is important for an auditor to determine that the taxpayers are consistent from year-to-year in the manner in which they include (or exclude) in transit inventory in the property factor. If in transit inventory is not being uniformly treated among the various states in which a taxpayer operates, this non-uniform treatment may give rise to property being classified as "nowhere property" and, therefore, not includible in the denominator. REF: paraphrased from MTA discussion of Property factor Maryland.

(10) Mobile or Movable Property

The value of mobile or movable property such as construction equipment, trucks, or leased electronic equipment, which are located within and without this state during the tax period shall be determined (for numerator purposes), based on the total time within the state during the tax period. This determination can be made (depending on the property in question) based on revenue, miles, time, etc. in Illinois divided by the like basis everywhere. This percentage would then be applied to the original cost of the property. REF: IAC § 100.3350(d).

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Example

Corporation W owns $33,000,000 of construction equipment, which is used during the year throughout the United States. During the current tax year the taxpayer's records showed that the equipment in question was used in Illinois for 122 days. The equipment was used outside Illinois for the other 243 days of the year. W should therefore compute the Illinois portion of this equipment as follows:

IL Property = (122/365 X $33,000,000) = $11,000,000

An automobile assigned to a traveling employee should be included in the numerator of the factor of the state to which the employee's compensation is assigned under the payroll factor or in the numerator of the state in which the automobile is licensed. REF: IAC §100.3350(d).

In the case of an airplane, helicopter, etc. the time computation would include flight time over Illinois territory. REF: Sunshine Letter IT91-0274

(11) Computer Industry – Property Factor

Corporations engaged in the development of computer software, which conduct activities within and without this state are required to determine and report business income derived from sources within this state by an apportionment formula.

(a) Software In The Property Factor

In general, for Illinois income tax purposes computer software is considered intangible personal property. The cost of computer software should generally not be included in the computation of the property factor under IITA § 304(a)(1). However, where for federal income tax purposes of the cost of computer software is included in the adjusted basis of computer hardware or other tangible personal property, such treatment applies for purposes of the IITA. Therefore, software costs may be included in the property factor only to the extent they are treated as part of the cost of the hardware or other tangible personal property for federal income tax purposes.

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For federal income tax purposes, the cost of computer software is generally either expensed as incurred, or capitalized as an item of intangible personal property. However, in certain limited circumstances software costs are capitalized as part of the cost of computer hardware or other tangible personal property. Treasury Regulations § 1.236(a)-4 provide rules regarding the capitalization of costs for intangible assets. These rules explicitly extend to costs of computer software.

(12) Inventory Kept At a Printer By a Publisher

Any paper stocks of a publisher shipped to an Illinois printer by the publisher should be reflected as Illinois inventory in the computation of the property factor. REF: Audit Review Bulletin FY 84-1.

(13) Idle Property

Property used in the regular course of the trade or business of the person shall remain in the property factor until its permanent withdrawal is established by an identifiable event such as its conversion to the production of nonbusiness income, its sale, or the lapse of an extended period of time (normally five years) during which the property is held for sale. REF: IAC § 100.3350(b).

(14) Intangible Drilling Costs

The IRS regulations define intangible drilling costs (IDCs) as any cost incurred that, in itself, has no salvage value and is "Incident to and necessary for drilling of wells and the preparation of wells for the production of oil and gas." The federal regulations furnish examples of these costs, which include such items as wages, fuel, repairs, hauling, supplies, etc., incurred in drilling, clearing and draining of the ground, road making and so on.

At the taxpayer's option, the IDC may be charged to capital or expensed. This election is available to the taxpayer under IRS Regulations Section 1.612-4(a). Most oil and gas companies will make the election to expense the IDC.

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Illinois had always taken the position that only capitalized IDCs could be included in the property factor since, if the taxpayer expensed the IDCs, the taxpayer had never "acquired" an asset for federal purposes. However, in September of 1992, the Circuit Court of Cook County handed down a decision in the case of Shell Oil Company et al v. Illinois Department of Revenue which caused the Department to reverse this position. Therefore, for all tax years for which the statute of limitations for issuing a notice of deficiency or filing a claim has not expired, IDCs should be included in the property factor whether or not they have been capitalized or expensed for federal purposes.

In January 1994, the Department of Revenue officially published its position by adopting IAC § 100.3350(e)(2). This section provides that capitalized IDC's shall be included in the property factor, regardless of whether they have been expensed for federal or state tax purposes. Intangible drilling and development costs include such elements as wages, fuel, repairs, hauling, draining, road building, surveying, geological works, construction of derricks, tanks, pipelines, and other physical structures necessary for the drilling of wells and their preparation for the production of oil and gas, and supplies incident to and necessary for the drilling of wells and clearing of ground.

(15) <u>The Outer Continental Shelf (OCS)</u>

The Outer Continental Shelf Lands Act extended the jurisdiction of the United States to property located beyond the three-mile state jurisdictional limit to the area of the ocean where the outer continental shelf ends. The federal jurisdiction in the area extends to all artificial islands and fixed structures erected on the shelf. The states are prohibited from imposing taxes, either directly or indirectly, on the revenues derived from areas under federal jurisdiction, such as the OCS.

Taxpayers have contended that since the states are prohibited, by federal statute, from taxing the revenues from the OCS, those revenues should be excluded from the tax base. They further felt that the property, payroll and revenues from these activities should be excluded from the apportionment formula computations. The states, on the other hand, have taken the position that OCS activities are includible in both the tax base and in the denominators of the apportionment formula factors.

On November 8, 1988 the Supreme Court held, in the case of Shell Oil Company vs. Iowa Department of Revenue, that the Federal

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preemption is "exclusively concerned with preventing the adjacent states from asserting, on the basis of territorial claims, jurisdiction to assess direct taxes on the Outer Continental Shelf...This is a far cry from prohibiting a State from including income from OCS-derived oil and gas in a constitutionally permissible apportionment scheme." The Court further held that the inclusion of earnings derived from these offshore drilling operations were includible in a state's pre-apportioned tax base;

"[I]t is irrelevant for the makeup of the apportionment formula's unitary tax base that third party sales occur outside of the State...Actual sales on the OCS (as opposed to internal accounting sales) are not taxed directly by any State because they are not included in the numerator of the sales ratio...From the inclusion of such sales in the apportionment formula's tax base, it does not follow that the dollar amount derived from the formula (which is a fraction of the unitary tax base) includes income not fairly attributable to Iowa."

When dealing with offshore drilling operations then, earnings from any activities occurring on the OCS should be included in the tax base and any property, payroll and sales should be included in the everywhere factors of the apportionment formula. Oil in transit from this area should be included in the destination state's property factor numerator. Sales taking place on the OCS would not be included in any state's sales factor numerator, however any oil that is piped out or hauled out of the OCS area by the driller and subsequently sold can be allocated to the destination state for sales factor purposes.

The Florida Supreme Court in the case of Shell Oil Company vs. Department of Revenue, State of Florida, also upheld the position that revenues from offshore drilling operations could be included in business income.

Refer to audit manual Chapter 37 (new 49) for synopses and the complete case citations of the Shell Oil Company cases.

(16) <u>Leased Property</u>

When a taxpayer leases property to another person, the use of the property in Illinois by the lessee would create sufficient nexus to tax the owner-lessor of the property. Accordingly, the original cost of the leased property should be included in the numerator of the property factor of the taxpayer.

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EXAMPLE 1

Corporation T leases trucks to other companies that travel through Illinois. T is commercially domiciled in Tennessee and has no other activity than the leasing of the trucks. T would include the original cost of these leased vehicles used in Illinois in the numerator of the property factor (also in the denominator).

EXAMPLE 2

Corporation V leases DVD movies and DVD players to a non-related corporation. The lessor is incorporated in the state of Texas. V has no offices or employees in Illinois. The lessee rents the movies and DVD players to hotels and motels throughout the country. Movies and players valued at $1,000,000 are leased to hotels in Illinois. V would be taxable in Illinois and would include, in the numerator of the Illinois property factor, these $1,000,000 in movies and players.

The IITA and Regulations are specific in their definition of property to be included in the numerator of the property factor. These definitions include the phrase "used in this state". It is for that reason that a lessor would include the leased goods in their computation of the numerator of the property factor. They are using this property in Illinois. The use is the leasing activity.

It should be noted that in both the above examples, the lessee would also have a property factor in Illinois. The numerator would be developed from the rental of the property in Illinois (i.e. annual lease payments multiplied by 8).

(17) Entertainment Industry

These paragraphs deal with issues and problems, which are somewhat unique to the entertainment industry. Definitions of terms used commonly in the entertainment industry appear at the end of the section. The following types of business activities should be considered part of this industry:

1. Motion picture producers (major, independent and television)

2. Television commercial producers

3. Television networks

4. Independent television stations which

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a) Operate as network affiliates, or

b) Are unaffiliated with a network but which operate collectively in purchasing properties for telecast or in marketing air time, or

c) Operate as a producer in a manner similar to the entities identified above.

The problems associated with these businesses involve the type of property owned or rented (and appropriate amounts) and revenues generated in the normal course of their trade or business activities. The following paragraphs discuss these problems and provide some direction in computing the factors for the entertainment industry.

(a) Entertainment Industry – Property Factor

(i) Everywhere

The basis for the computation of the property factor can be found in IITA § 304(a)(1)(A). When dealing with producers or television networks the property factor should include:

1. Sets, props, wardrobes, etc. These items are all considered tangible personal property used in the business.

2. Videocassettes and disks valued at their cost. These assets are usually found in the Inventory accounts.

3. Films. Films are also considered tangible personal property. This position is supported by judicial decisions regarding IRC, "Section 38 property." Section 38 of the IRC provides for an investment credit on the cost of such property. Section 38 property is limited to tangible personal property and certain structures on real property. In the case of Walt Disney Productions v. United States [71-2 USTC para. 9507], 327 F. Supp. 189 (C.D. Cal. 1971), affirmed as modified, [73-2 USTC para. 9484], 480 F. 2d. 66 (9th Cir. 1973), cert. denied. the US Tax Court held that motion picture negatives are tangible personal property and allowable

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for Investment Tax Credit purposes.

Films (whether incomplete or complete but not yet released) should not be included in the property factor until their release date(s) since, until their release, they are not being used in the trade or business. Films may be released to theaters, television stations and television networks. They may also be released by a television network for telecast. Syndicated television programs should be included in the property factor only when they are actually in syndication and shown on the air. However, films, which have been previously released but are currently, temporarily in storage, should also be included in the property factor. This position is based on IAC § 100.3350(b)).

Films should be valued at original cost regardless of whether they are being released for the first time or being re-released. The original cost of the film should include all capitalized costs associated with producing the film, as determined for federal income tax purposes. Some examples of these costs are:

a) General overhead costs as they apply to the film such as, preparing a script from a story, building sets, hiring and rehearsing talent, editing of original film negatives, etc.

b) Compensation paid to actors, production personnel, directors, and producers.

c) Costs of the "first" distribution of prints.

d) Costs of the screen rights and other material being filmed.

e) "Residuals" payable under contracts with labor organizations.

f) Participations payable as compensation to actors, production personnel, directors and producers.

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REF: IRC Section 48(k)(5), and the case of Walt Disney Productions v. United States, [74-2 USTC para. 9623], [76-2 USTC sec. 9606], affirming and remanding District Court decision, [77-1 USTC sec. 9398] (as amended).

4. Rented property should be valued at eight times the annual rental expense. The amount of rental expense used should include:

a) Lump-sum net rental payments for a period, which encompasses more than a single income year, assigned ratably over the rental period.

b) Amortized film rentals.

c) License fees paid for the exhibition or telecast of films or television series. These fees are paid under leases, which allow the films or series to be shown or broadcast for a scheduled number of times and/or during a limited period of time. Since the films or series are considered tangible personal property, the fees are considered rent expense and should be included in the property factor.

Also, in the case of United Artists Corporation v. Taylor (New York), the court held that a film was tangible personal property and that a transfer of the film to the motion picture theaters with a license to show the film constituted a taxable rental or license to use the film as tangible personal property under the New York City Retail Sales and Use Tax Law. The complete case citation can be found in Chapter 37(new chapter 49)

d) When dealing with rented studios, the amount of the basic or flat rental charge by the studio for the use of a stage and other permanent equipment such as sound recording equipment.

e) Additional equipment rented from other sources or from the studio that is not covered in the basic or flat rental charge.

(ii) <u>The Numerator</u>

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When computing the Illinois numerator of the property factor, tangible personal property should be assigned to Illinois if it is located or used in this state at any time during the taxable year. Its value for numerator purposes should be determined using a ratio which compares the number of days the property was located in Illinois to the total number of days the property was owned or rented during the taxable year. Daily Shooting Schedules can be a useful tool in establishing the daily location of property.

The original cost of the film (as defined above) should be prorated over the number of copies of the film in release. The cost, per copy, should be allocated to Illinois for numerator purposes based on a fraction the numerator of which is the number of days the copy was located in Illinois and the denominator of which is the number of days it was in release anywhere.

(18) Operating Lease v Capital Lease

(a) Book Purposes

Leases can be classified as capital leases or operating leases. Many complex tests must be performed to determine if a lease is an operating or a capital lease. Simply put, however, these two types of leases can usually be distinguished by asking four questions:

1. Is ownership transferred?
2. Does a bargain purchase option exist in the language of the lease?
3. Do the terms of the lease extend beyond 75 % of the asset's life?
4. Does the present value of the minimum lease payments equal or exceed 90 % of the leased property's fair market value less investment tax credit retained by lessor?

(b) Lessee

If the answer to any of these questions is yes, then the lease should be treated as a capital lease. Among other book entries,

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the property will appear on the lessee's balance sheet, and the lessee will compute a depreciation expense on the property for purposes of its income statement.

If none of the questions are answered with a yes, the lease should be classified as an operating lease. In this case, the lessee will claim rental expense for purposes of its income statement.

(c) Lessors

Lessors would also classify the lease as an operating lease if the answers are "NO". If any of these questions were answered "YES" a lessor would subject the lease to further tests. These tests would deal with rent collectability; future cost predictability, dealer profit, etc. REF: A PRACTITIONER'S GUIDE TO ACCOUNTING FOR LEASES, The Journal of Accountancy, August 1977 and FAS No. 13.

(d) Federal Purposes

For federal purposes, the lease agreement is evaluated to determine whether it is a lease or a conditional sale. If the agreement is determined to be an actual lease, the lessee is allowed a rental deduction in the computation of federal taxable income (IRC Sections 162 and 263). If the agreement is determined to be a conditional sale, no rental deduction is allowed, however, the lessee is allowed to deduct depreciation expense on the assets.

If the agreement is determined to be an actual lease, the lessor must report rental income on its federal return and is allowed a depreciation expense for the property being leased. If the agreement is determined to be a conditional sale, the lessor must report a capital gain on the sale of the property.

(e) Illinois Purposes

Illinois will generally rely upon the federal determination of whether an agreement is an actual lease or a conditional sale. However, the Department will also be guided by the "economic substance" of the transaction in determining whether a sale, license or lease has occurred for Illinois income tax purposes. The agreement should reflect an arm's length negotiation. In the

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absence of a bona fide non-tax motive, the form of a transaction may not be recognized. The economic substance of a transaction necessarily depends upon the particular facts of each case. REF: Sunshine Letter IT91-0082.

When computing the property factor, a problem can arise if an agreement is classified as a capital lease for book purposes and an actual lease for federal income tax purposes since the taxpayer is allowed to use the book balance sheet as Schedule L on its federal return. It is possible for the taxpayer to inadvertently "double up" the capital lease in the property factor by including the capitalized value from the balance sheet and the rent expense from Page 1 of the 1120.

In these cases (unless the federal determination is going to be disregarded), if the taxpayer is allowed to claim a rent expense on the federal return, the rent expense is included in the property factor and the capitalized value of the property is eliminated. If the taxpayer is not allowed to claim a rent expense on the federal return, the capitalized value of the property should be included in the computation of the property factor.

(f) Safe Harbor Leasing

Safe harbor leasing was removed from the IRC. Simply put, safe harbor leasing deemed certain arrangements to be true leases. For purposes of Illinois taxation, the property factor follows the characterization of an arrangement as a lease for federal purposes.

b) The Payroll Factor

The payroll factor is addressed under IITA § 304(a)(2) and in IAC § 100.3360. There have been no amendments to § 304(a)(2) of the Act since 1969. The following discussion is based primarily on those sources.

IITA § 304(a)(2) provides the guidance on how compensation/payroll is treated in apportionment. The payroll factor is a fraction with the numerator being the total amount of compensation paid within Illinois during the taxable year. The denominator is the total amount of compensation paid everywhere during the taxable year.

The total amount "paid" during the taxable year is determined on the basis of the employer's accounting method. If the employer uses the accrual

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method of accounting for payroll purposes, then all compensation properly accrued would be deemed paid during the taxable year for which it was accrued.

The payroll factor includes only compensation paid to employees primarily engaged in the production of business income. Compensation paid to employees primarily engaged in the production of nonbusiness income is excluded from the payroll factor. In general, however, compensation of general executive officers with company-wide authority is included in the payroll factor.

(1) Compensation Paid In Illinois

The numerator of the Illinois payroll factor consists of compensation paid in Illinois. The tests for determining whether compensation is paid in this state are substantially the same as those used in other states. Compensation is paid in this state if:

1. The individual's service is localized in this state because it is performed entirely within this state.

   For tax years ending on or after December 31, 1992, when services are performed (pursuant to a personal service contract for sports performances) by any member of a professional sports team which is based in a state that imposes a comparable tax liability on members of professional sports teams headquartered in Illinois, the performance of that personal service at a sporting event taking place in Illinois shall be considered to be a performance entirely within this State. REF: PA 87-0880.

   NOTE: For more information regarding the effect of PA 87-0880, refer to the (Personal Services – Professional Athletes) section below.

2. The individual's service is localized within this state although it is performed both within and without this state but the service performed outside this state is incidental to the individual's service performed within this state.

3. The individual's service is not localized in any state, but some of the service is performed within this state and either:

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a) The base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within this state, OR

b) The base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

REF: IITA § 304(a)(2)(B).

(2) Entertainment Industry Payroll

The payroll factor should include:

1. Compensation paid to all employees during the taxable year, including talent salaries.

   When examining the amount of talent salaries or determining the proper assignment of those salaries by state, UC-3/40's should not be relied upon. Daily Shooting Schedules will provide more accurate data for payroll factor purposes.

2. Residual and profit participation payments paid to employees.

3. Any amount paid by a producer to a corporation for providing (or loaning) the services of an actor or director who is an employee of the corporation or is under contract with such corporation. These payments should be included in the producer's payroll factor as if the amount paid was compensation paid to an employee of the producer.

For purposes of the payroll factor numerator, compensation of employees engaged in the production of a film on location should be attributed to Illinois if the services were performed in Illinois.

(3) Professional Athletes Payroll

The discussion below assumes that the athletes are involved in an employer-employee relationship with a team. If an athlete is an independent contractor (a golfer, a racer, a bowler, etc.) and is a

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nonresident of Illinois, any business income received should be apportioned to Illinois individually by use of a 3-factor formula. SUNSHINE LETTER IT 88-0403.

For purposes of the denominator, the payroll of the actual players and all other employees required to travel with the team should be included. Bonus payments, optioned player payments and other remunerations should also be included in the payroll factor only if they are the result of play (such as performance bonuses) or are conditioned upon the player making the team or performing services. This type of payroll information can be obtained by examining the contracts entered into between the teams and owners.

For tax years ending prior to December 31, 1992, there was no specific provision in the Act or Regulations for any type of apportionment of compensation paid to a professional athlete. Therefore, any salaries paid to employees of the organization (players, coaches, support crews, etc.) would be considered compensation paid in this state and attributed to Illinois for purposes of the numerator of the payroll factor based on the following tests which are contained in IITA § 304(a)(2)(B) of the IITA.

Any individual who:

1. Performs all of his/her services within Illinois, or performs services within and without Illinois but the services performed outside of Illinois are incidental to the ones performed within Illinois, or

2. Performs some services within Illinois and the base of operations or the location from which the services are directed or controlled is located in Illinois, or

3. Performs some services within Illinois and there is no base of operations or location from which the services are directed or controlled and the individual is a resident of Illinois.

IITA § 304(a)(2)(B)(iii) governs when compensation is paid in Illinois. This section of the IITA was amended by PA 87-0880 to read that a comparable tax liability would be imposed on residents of those states

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(professional athletes) which tax residents of this state. Services by professional athletes at a sporting event taking place in Illinois shall be deemed to be a performance entirely within this State. This has been in effect for all taxable years ending after December 31, 1992.

Since Wisconsin and Michigan are reciprocal states, Illinois will recognize the reciprocal agreement with regard to PA 87-0880 to the extent that the reciprocal state does not tax players from Illinois teams. REF: Sunshine Letter IT93-0117.

For players and other team employees who are subject to this provision, the amount of income constituting compensation paid in Illinois will be determined by multiplying the person's total compensation for performing such personal services by a fraction, the denominator of which is the total number of duty days in the taxable year and the numerator of which is the number of duty days in Illinois during the taxable year. REF: IAC § 100.3120(a)(3)(A)

EXAMPLE

The California Turtles is a professional sports team whose operations are directed and controlled in California. The Turtles play their home games in California and their away games in several other states, including Illinois.

On the Turtles' IL-1120, a payroll factor would exist for tax years ending on or after December 31, 2012. Per IITA § 304(a)(2)(B)(iii), each sporting event taking place in Illinois is considered a performance entirely within Illinois, if the resident state imposes a comparable tax on Illinois players. Any compensation paid by the Turtles for a sporting event taking place in Illinois, is compensation paid in Illinois per IITA § 304(a)(2)(B)(i).

Duty days are days during any part of which the person is under a duty to perform personal services under the terms of his or her personal service contract.

Total duty days for players includes:

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1. All days from the beginning of the official pre-season training period through the last game in which the team competes.

2. If a team is involved in post-season (play-off) games, all days through the last post-season game in which the team participates.

3. Any all-star games falling outside the preseason, regular season and postseason period, in which the player is chosen to participate.

4. Off days, practice days and travel days.

With the exception of travel days, a duty day in Illinois equals one day for any part of a duty day during which the employee is physically present in Illinois. In the case of a travel day, only days in which the person spends at least 8 hours in this State will be considered a duty day. REF: IAC § 100.3100(e).

(4) Sources Of Payroll Information

The taxpayer has the option of using either an accrual or cash method of accounting for wages in the payroll factor. The taxpayer should be consistent and use the same basis for computing the numerator and the denominator.

Generally, whichever method the taxpayer uses in computing the payroll factor (i.e. cash method or accrual method) is the method that should be utilized when auditing the payroll factor. If the taxpayer uses the cash method and the accrual method is utilized by the auditor (or vice versa), differences may be noted in the results of the factor values. These discrepancies are the result of timing differences. In general, however, the cash basis is the preferred method in computing the payroll factor. This is due to the ease in preparing and checking the computation.

Sources for obtaining information relating to wages paid can usually be obtained from the following:

(a) Cash Method

In verifying everywhere payroll figures (i.e. the denominator) these Federal Withholding Tax forms will generally be utilized:

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1. Federal Form 941 [Quarterly return]
2. Federal Form 940 [Annual return]

In verifying Illinois payroll figures (i.e. the numerator) the values can generally be obtained from the Illinois Unemployment Compensation form known as IL UC-3. This return is filed quarterly for unemployment taxes withheld by an employer. The withholding of these unemployment taxes is not dependent on where the employee resides but rather where the employee's duties are performed.

Generally, the UC-3 should be used in obtaining Illinois payroll instead of the IL-941. The reason the IL-941 may not be a reliable and accurate source in determining Illinois payroll is because the IL-941 would not reflect wages paid to employees working in Illinois who are not residents of Illinois.

The State of Illinois has Reciprocal Withholding Agreements with the States of Iowa, Kentucky, Michigan, and Wisconsin. Indiana was in a reciprocal withholding agreement with Illinois up until the tax year ending December 31, 1997. The agreements allow Illinois employers to withhold the appropriate state income taxes from these non-IL residents. These wages would not be reflected on the IL-941's.

The cash basis may be most conveniently used when the taxpayer's year-ends on a calendar quarter (i.e. March 31st, June 30th, September 30th, or December 31st). However, it is possible to use the cash basis when the taxpayer's year ends on any date. This may pose a slightly more time consuming computation but it can be done since the taxpayer will have payroll records that support these Federal and State tax forms on a payroll period basis (i.e. weekly, bi-weekly, monthly, etc.).

In verifying everywhere payroll figures total wages can be obtained from the Federal 1120 Return line items titled:

1. Compensation of Officers [from Page 1]
2. Salaries and Wages [from Page 1]
3. Costs of Labor [from Sch A--COGS Schedule]

In verifying Illinois payroll figures the values would have to be obtained from the detail that made up the Federal 1120 line items mentioned above. At times this may prove to be

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somewhat time consuming and difficult. The most common error made by the taxpayer in using this method is in making improper accruals or no accruals at the beginning or end of the year for the Illinois payroll of the payroll factor.

Differences between the accrual and cash method will be due primarily to the fact that the Federal 941 reports and the State UC-3 reports are prepared on a cash basis while the Federal 1120 is usually prepared on an accrual basis.

(5) 401(k) Earnings

Earnings included in a qualified cash or deferred compensation arrangement under IRC Section 401 (k) which are excluded from federal taxable income are included in both the numerator and denominator of the Illinois payroll factor if they were earned by a resident of Illinois. If they were earned by a nonresident of Illinois, these amounts would only be included in the denominator of the payroll factor. REF: IAC § 100.3120(c).

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Partnership, S Corporation, Trust & Estate, Pass-Through Entity & Composite Returns

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I. PURPOSE

This chapter deals with the statutes, regulations and procedures involved in auditing partnerships, Subchapter S corporations, trusts and estates and composite and pass-through entity returns. In some instances, the procedures for auditing a certain area of these returns are similar to those involved in auditing an 1120 return. In these cases, cross-references are made to the appropriate paragraphs or chapters.

II. REFERENCE SOURCES

A. Illinois Income Tax Act (IITA)

IITA § 102
IITA § 201
IITA § 202.3
IITA § 202.4
IITA § 203 (b),(c),(d),(e)
IITA § 204
IITA § 205
IITA § 207
IITA § 214
IITA § 216
IITA § 217
IITA § 218
IITA § 217.1
IITA § 219
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IITA § 221
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IITA § 223
IITA § 301
IITA § 303
IITA § 304
IITA § 305
IITA § 306
IITA § 307
IITA § 308
IITA § 403
IITA § 405
IITA § 502
IITA § 503
IITA § 505
IITA § 601
IITA § 709.5
IITA § 711
IITA § 1501(a)(4), (11.5), (16), (18), (20), (22), (27), (28)

B. Illinois Regulations (IAC)

86 IAC § 100.2101
86 IAC § 100.2110
86 IAC § 100.2160
86 IAC § 100.2185
86 IAC § 100.2190
86 IAC § 100.2197
86 IAC § 100.2198
86 IAC § 100.2320
86 IAC § 100.2330
86 IAC § 100.2405
86 IAC § 100.2410
86 IAC § 100.2430
86 IAC § 100.2450
86 IAC § 100.2455
86 IAC § 100.2490
86 IAC § 100.2470
86 IAC § 100.2480
86 IAC § 100.2490
86 IAC § 100.2655
86 IAC § 100.2850

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86 IAC § 100.3010
86 IAC § 100.3015
86 IAC § 100.3220
86 IAC § 100.3300
86 IAC § 100.3320
86 IAC § 100.3380
86 IAC § 100.3500
86 IAC § 100.5100
86 IAC § 100.5130
86 IAC § 100.5140
86 IAC § 100.5150
86 IAC § 100.5160
86 IAC § 100.5170
86 IAC § 100.5180
86 IAC § 100.5201
86 IAC § 100.5270
86 IAC § 100.7035
86 IAC § 100.9700
86 IAC § 100.9720
86 IAC § 100.9730
86 IAC § 100.9750

C. Department Publications

Publication 101
Publication 120
Informational Bulletin FY 2006-07
Informational Bulletin FY 2011-09
Informational Bulletin FY 2015-09

D. Internal Revenue Code (IRC)

IRC § 1
IRC § 40
IRC § 43
IRC § 45
IRC § 78
IRC § 170
IRC § 171
IRC § 172
IRC § 265
IRC § 267
IRC § 280
IRC § 291
IRC § 363
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IRC § 642
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IRC § 666
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IRC § 675
IRC § 676
IRC § 677
IRC § 678
IRC § 669
IRC § 701
IRC § 703

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IRC § 704
IRC § 706(b)
IRC § 707
IRC § 761
IRC § 832
IRC § 852
IRC § 901
IRC § 936
IRC § 1202
IRC § 1221
IRC § 1231
IRC § 1341
IRC § 1348
IRC § 1361
IRC § 1362
IRC § 1363
IRC § 1364
IRC § 1366
IRC § 1378
IRC § 1402
IRC § 1403
IRC § 6231
IRC § 7701
IRC § 7704

E. Federal Regulations (CFR)

26 CFR § 1.444-3T
26 CFR § 1.641
26 CFR § 1.651
26 CFR § 1.671-4
26 CFR § 1.701-1
26 CFR § 1.704-1
26 CFR § 1.706-1T
26 CFR § 1.172-4
26 CFR § 1.1366-1
26 CFR § 1.1372-4
26 CFR § 1.6012-3
26 CFR § 1.6031
26 CFR § 1.6032
26 CFR § 18.1366-5
26 CFR § 301.7701-6
26 CFR § 301.7701.4

F. Federal Publications

Publication 536
Publication 538
Publication 541

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III. GENERAL INFORMATION

A. Tax Rates

Current and prior year Business Income Tax rates, Individual Income Tax rates and Personal Property Replacement Tax rates can be found at the Illinois Department of Revenue website at:

https://www2.illinois.gov/rev/research/taxrates/Pages/default.aspx

The current 1.5% replacement tax rate for partnerships, trusts and S corporations has been in effect since the tax was enacted effective July 1, 1979.

- The tax increases under P.A. 096-1496 effective for income received on or after January 1, 2011 and P.A. 100-0022 effective for income received on or after July 1, 2017 does not affect the replacement tax rate but does affect the income tax rate on pass-through income received by individuals, trusts & estates, and corporations (other than S corporations).

Schedule SA
The purpose of Schedule SA, Specific Accounting, is to provide a means for calculating your income and tax at separate rates, due to an income tax rate increase in the middle of the tax year. The Schedule SA allows you to figure your tax based on the specific accounting method, which allows you to treat your net income or loss and modifications as though they were earned in two different taxable years. Schedule SA must be used if the blended rate method of computing tax was not elected. The blended rate method taxes your income as if you received it evenly throughout the year.

There is a separate Schedule SA for composite returns, individuals, corporations, fiduciaries and exempt organizations. For fiscal year filers Schedule SA contains instructions on how to prorate the income between the two periods.

The income tax rates preprinted on the 2010 income tax returns were not changed, however the Department created the new “Schedule SA” to attach to the return that separates income earned before and after January 1, 2011 and then calculates tax at the correct rate.

If prior to 12/31/2014, an S corporation or partnership files Form IL-1000, Pass-through Entity Payment Income Tax Return, on behalf of its nonresident partners

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and shareholders, the income tax rate increase must be accounted for in the payment amount.

Refer to the following Informational Bulletins on the Illinois Department of Revenue website and the Schedule SA: Specific Accounting Method of Computing Net Income applicable to your tax type for more information.

FY 2011-09 Illinois Income Tax increase
FY 2015-09 Illinois Tax Rate Decrease
FY 2018-02 Illinois Income Tax Increase Guidance

B. IL-872 Extension of State of Limitations

Public Act 92-0846 amended IITA § 905(f) to provide that a partnership, Subchapter S corporation, or a trust who executes an extension with the Department on or after January 1, 2003, will also extend the statute of limitations for partners, shareholders, or beneficiaries of the flow-through entity. However, any assessment shall be limited to the amount of the deficiency resulting from the recomputation of income, deduction, credits, or other amounts of the taxpayer that are taken into account by the partners, shareholder, or beneficiary in computing its liability under the IITA.

IV. APE SPECIFIC LAW APPLICATIONS

A. Partnerships

Partnerships can be complex business entities. They are similar to post-1982 Subchapter S corporations; however, they are more complicated due to the fact that there is no limit on the number of partners, nor is there a restriction on who can be a partner. Partnerships may have corporate partners, individual partners, partnerships as partners, etc. This can make tracing the flow of income and expense items through to the partners' returns difficult.

Partnership Definition

IRC § 761(a) defines a partnership to include the following:

> a syndicate, group, pool, joint venture, or other unincorporated organization through, or by means of which any business, financial operation, or venture is carried on, and which is not within the meaning of this title..., a corporation or a trust or estate.

IITA § 1501(a)(16) defines a partnership in the same way, but adds:

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The term “partnership” includes any entity, including a limited liability company formed under the Illinois Limited Liability Company Act, classified as a partnership for federal income tax purposes.

The term “partnership” does not include a syndicate, group, pool, joint venture, or other unincorporated organization established for the sole purpose of playing the Illinois State Lottery.

IRC § 761(a) also permits a partnership to elect to be disregarded, so that all of its income and other tax items are deemed earned directly by its partners. An entity that makes this election is not a partnership for Illinois income tax purposes. See 86 IAC § 100.9750(d) for more detail.

A partner under this section of the IITA is defined as “a member in such syndicate, group, pool, joint venture or organization.”

In 1996, the Treasury adopted the “check the box” regulations in 26 CFR §§ 301.7701-1 thru -4. Under these regulations, entities formed under one of a long list of domestic and foreign laws are taxed as corporations. All other entities (especially including limited liability companies) may elect to be treated as corporations. If no election is made by an entity with only one owner, the existence of that entity separate from its owner is disregarded. If the entity has more than one owner, it is treated as a partnership unless it elects corporate treatment.

The following is a brief list of definitions which are used in describing partnerships and their activities.

- **Partner** - is a "person" who owns an interest in a partnership which was acquired through either contributions of capital or services or both.

- **General Partner** - is involved in the management of the partnership and has unlimited liability.

- **Limited Partner** - usually is not liable for general debts of the partnership and has no voice in the operation of the business. Limited Partners are, by definition, inactive in the Partnership. Their distributive share of IRC Sec. 702(a)(8) taxable income is not “compensation,” and as such, cannot be “reasonable compensation” for purposes of the PSI/Reasonable compensation subtraction modification (IITA 203(d)(2)(H)).

- **Principal Partner** - is one who has a 5% or more interest in the profits or capital of the partnership. A partner's share of income, gains, losses,

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deductions, or credits is usually controlled by the partnership agreement. REF: IRS Publication 541.

- **Publicly Traded Partnership** - as defined in IRC § 7704(b), means any partnership, if:

  - Interests in the partnership are traded on an established securities market; or

  - Interests in the partnership are readily tradable on a secondary market.

  Most publicly traded partnerships are treated as corporations for tax purposes.

- **Non-Recourse Loans** - are liabilities of the partnership for which none of the partners have any personal liability.

- A partner is considered **"AT-RISK"** in an activity to the extent of their cash and the adjusted basis of other property which they contributed to the activity and certain amounts borrowed for use in the activity. In other words, "at-risk" usually means the amount that the partner stands to lose economically in the event that the enterprise should fold altogether. IRC § 465 essentially limits a partner's loss (that is, distributive share of income or loss minus distribution for the entire time the partner was a partner) to the amount that the partner has at risk and could actually lose from an activity.

- **Material Participation** - is the involvement in the operations of the activity of the partnership on a regular, continuous, and substantial basis. Material participation is determined by a number of tests under IRC § 469(h).

- **Passive Activity** - is an activity which involves the conduct of a trade or business, but in which the taxpayer does not "materially participate". REF: IRC § 469(c).

<u>Prior to 1996</u>

For years before the check-the-box rules were adopted, the determination of whether or not an entity was a partnership for income tax purposes could be difficult. A partnership is an association of two or more persons (partners) who join together to operate a trade or business, with each person contributing money, property, or services and with all such persons agreeing and expecting to share in the profits and losses of the business. A partnership, under the IRC, is treated as a pass-through entity rather than a taxable entity, functioning primarily as a conduit

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for transferring income and loss items directly to the individual partners who report such items on their own income tax returns. The partnership, however, is entitled to make most federal tax elections affecting the computation of partnership income.

Generally, the only real distinction between a joint venture and partnership is the scope of the business activity and the duration of the association. Joint ventures are ordinarily formed to conduct some limited business activity or transaction, for example, to develop a particular tract of land, and are intended to exist only so long as necessary to complete the project. Partnerships are generally engaged in a wider range of business activities and are intended to exist for a longer period of time.

For purposes of distinguishing a partnership from an association taxable as a corporation, a business entity is considered a partnership if it has more non-corporate characteristics than corporate characteristics.

The following “common law” characteristics were developed by the courts, and are not statutory:

- It must have associates.
- There must be an objective to carry on a business.
- It must have continuity of life.
- There must be centralization of management.
- There is limited liability for corporate debts.
- There is free transferability of interest.

Both partnerships and corporations must have associates and an objective to carry on a business. Therefore, the corporation/partnership determination is based on the remaining four characteristics (otherwise referred to as the four-factor test prior to January 1, 1997). In order to be characterized as a corporation, the entity must meet at least 3 of these other characteristics. Otherwise, the entity will be characterized as a partnership. There is no requirement that a partnership be labeled as such in order to be one. Conversely, merely labeling it as a partnership does not guarantee it will be treated that way for tax purposes. Generally, this determination will have been made at the federal level.

IRC § 761(a) provides a special opt out for partnership treatment of certain passive investment and joint production and extraction entities. This election allows the parties to treat themselves as co-owners rather than as partners. In these

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instances, partnership tax returns do not have to be filed. See IRC § 761 Election below.

General vs. Limited

A partnership may be either general or limited. In a general partnership, each partner has broad liabilities. In a limited partnership, there must be at least one general partner who has broad liabilities and any number of limited partners whose liabilities are limited to the amount of their contribution to the partnership. They do not take part in the management of the partnership, but they do share in the profits or losses with the general partner(s). REF: Federal Taxation of Partners and Partnerships, Warner, Gorham and Lamont.

If a partnership is not recognized as such for federal tax purposes, it will most likely be treated as an "association" taxable as a corporation.

1. Federal Taxation of Partnerships

The federal tax treatment of any partnership item is determined at the partnership level, i.e., most elections affecting the computation of income from a partnership are made by the partnership, not by the separate partners. The income flows through to each partner who reports that partner's distributive share of the partnership's tax items, regardless of whether or not there has been an actual distribution of cash or other property by the partnership. This also applies to losses. That is, the partner reports a loss even if it has not been directly incurred. Generally, a partner's distributive share of the partnership loss is limited to the adjusted basis of the partnership interest at the end of the partnership year in which the loss was incurred. Much of the above information is contained in IRS Publication 541. This publication provides some good basic information about Federal taxation of partnerships.

a) Federal "Check-The-Box" Rules

The "check-the-box" regulations allow a "domestic eligible entity" with two or more members that is not a corporation (or a foreign entity that is not deemed by the regulations to be a corporation) to elect to be classified as either an association (and thus as a corporation) or a partnership. Although the classification is generally elective, the "check-the-box" regulations contain some default provisions. Under the default provisions, a multimember entity will be classified as a partnership unless it makes an affirmative election (i.e., checks the box) to be classified as a corporation.

The "check-the-box" regulations provide similar default provisions for entities which are not corporations and which have only one owner, such as single-

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member limited liability companies. Under these provisions, a single owner entity is disregarded as an entity separate from its owner unless it makes an election to be treated as a corporation. An eligible entity with a single owner cannot elect to be treated as a partnership. If a single entity elects to be disregarded as an entity separate from its owner, its activities will be treated in the same manner as a sole proprietorship, branch, or division of the owner.

The "check-the-box" rules can't be applied to determine the classification of a business entity prior to January 01, 1997. Thus, classification of an entity formed prior to January 01, 1997 must be analyzed under the four-factor test described under Section A, Partnerships, to determine their classification as a partnership or a corporation. If an entity claims to be a partnership, but it is later determined that the entity is taxable as a corporation, the entity will be treated as a corporation prior to January 01, 1997. If the entity then elects to be a partnership for periods beginning on and after January 01, 1997, the entity may be treated as distributing its assets in a taxable liquidation.

b) Foreign Entities

The "check-the-box" regulations provide that a "foreign eligible entity" with two or more members, where at least one member does not have limited liability, is classified as a partnership unless it makes an election to be treated as a corporation. A "foreign eligible entity" where all members have limited liability is classified as a corporation unless it makes an election to be treated as a partnership. A "foreign eligible entity" with one member, where the member does not have limited liability, is disregarded as an entity separate from its owner unless it makes an election to be treated as a corporation.

Classification of Entities for Illinois Purposes

IITA § 102 states:

> Except as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code of 1954 or any successor law or laws relating to federal income taxes and other provisions of the statutes of the United States relating to federal income taxes as such Code, laws and statues are in effect for the taxable year.

IITA § 1501(a)(4) states:

> The term "corporation" includes associations, joint-stock companies, insurance companies and cooperatives. Any entity, including a limited liability company

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> formed under the Illinois Limited Liability Company Act, shall be treated as a corporation if it is so classified for federal income tax purposes.

IITA § 1501(a)(16) states:

> ... Any entity, including a limited liability company formed under the Illinois Limited Liability Company Act, shall be treated as a partnership if it is so classified for federal income tax purposes. ...

Accordingly, the Department will follow the federal classification of entities under the "check-the-box" regulations (i.e., an entity which elects to be treated as a corporation for federal income tax purposes under the "check-the-box" rules will be treated as a corporation for Illinois income tax purposes and an entity electing to be treated as a partnership will be a partnership for purposes of the IITA) which became effective on January 01, 1997. The one exception to following the federal classification in IITA § 501(a)(16) is for partnerships established for the sole purpose of playing the Illinois State Lottery, which are not treated as partnership for Illinois purposes. Also see 86 IAC § 100.9750(d).

c) Tax Year Permitted

For partnership tax years beginning in 1987, all partnerships generally were required to adopt the same taxable year as the partner (or partners) who owned a majority (more than 50%) interest in the partnership profits and capital. If no combination of partners with the same tax year owns a majority interest, then the partnership must adopt the same tax year as that of all principal partners (a partner having an interest of at least 5 percent in partnership profits and capital). If a tax year cannot be determined under either of the above provisions, then the partnership must use the tax year resulting in the least aggregate deferral of income to the partners (26 CFR 1.706-1. Also see IRC § 706(b)). For most partnerships, the above provisions result in a calendar tax year being adopted.

One exception to this requirement is that a partnership is permitted to use its natural business year. (A natural business year ends shortly after a company's peak period of business.) In order to qualify for this exception, the partnership had to establish an acceptable business purpose for using a year end other than the required year end. REF: Publication 538

Another exception to the required year end is available under IRC § 444. A partnership may elect, under this section, to have a different year end, if certain conditions are met. IRC § 444 applied to the first taxable year beginning after December 31, 1986. See Section 444 Returns in Archives.

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d) Federal Form 1065

A partnership files a federal Form 1065 with the IRS. It is not required to file until the first year in which the partnership has income or deductions. Thereafter, a partnership is required to file every year whether or not it has actual income. The federal Form 1065 separately reports each class of partnership income, gain, loss, deduction, or credit taken into account in the separate income tax computation of the partners.

A partner is deemed to have received their entire distributive share of a partnership's income (loss) on the last day of the partnership's taxable year. If the partnership has a 12-month year end and a short taxable year end in the same tax year of the partner, the income (loss) from both years shall be included in the partner's return for the year. REF: IRC § 706(a).

The due date of the partnership return is the fifteenth day of the fourth month following the close of the taxable year, except that if the partnership consists totally of nonresident aliens, the due date of the partnership return is the fifteenth day of the sixth month following the close of the year. REF: CFR § 1.6031(a)-1(e)(2).

When a partnership is dissolved, the return for the short tax year must be filed within 3 1/2 months after dissolution. REF: CCH Standard Federal Tax Reports, Para.25362.013, Explanation for IRC Regulation 1.701-1.

Various information about the partnerships appear on the face of the federal Form 1065, including the number of partners and whether or not the partnership is a limited partnership; etc.

Income and expenses derived only from a trade or business activity are considered in determining the ordinary income (loss) of the partnership. These items are reported on page one of the federal Form 1065. The supporting schedule for cost of goods sold is reflected on Form 1125-A for tax years 2011 and forward. (Cost of goods sold was reported on Schedule A (Form 1065) for tax years 2010 and prior). The ordinary income (loss) for the partnership is then carried to Schedule K. Note that income from other rental activities and portfolio income are not included on page one. They are entered directly on Schedule K.

Form 8825 (which was effective with the 1990 return) was developed to report income and expenses from rental real estate activities of the partnership. It replaced the former Schedule H (Form 1065). The net income (loss) from the rental real estate activities is reflected on Schedule K.

Schedule K of the federal Form 1065 is a summary schedule of all the partners' shares of the partnership's income, credits, deductions, etc. which have been

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distributed, or deemed distributed, to its partners. This schedule must be completed by all partnerships.

For years ending prior to December 31, 1987, Schedule K was not required to be completed if there were ten or fewer partners.

Schedule K-1 (Form 1065) is prepared for each partner and shows that specific partner's distributive share of the income, deductions, credits, etc. included in the partnership figures on Schedule K.

Schedule L is the partnership's balance sheet.

Schedule M is the reconciliation of the partners' capital accounts, which reflects the total equity of all partners in the partnership at the beginning of the tax year, any adjustments that occurred and the equity at the end of the tax year.

Domestic partnerships with ten or fewer partners may not be required to complete Schedules L and M.

2. Illinois Taxation

The Illinois definition of a partnership parallels that of the Internal Revenue Code (IRC). 86 IAC § 100.9750(d)(1) states:

> 26 USC 761 provides that the term "partnership" includes a syndicate, group, pool, joint venture or other unincorporated organization through or by means of which any business, financial operation or venture is carried on, and which is not, within the meaning of this Title 26, a corporation or a trust or estate. This definition is essentially identical to the definition in IITA Section 1501(a)(16)). Also, IITA Section 1501(a)(16) provides that *any entity, including a limited liability company formed under the Illinois Limited Liability Company Act, shall be treated as a partnership if it is so classified for federal income tax purposes.* Accordingly, every entity treated as a partnership for federal income tax purposes is a partnership for purposes of the IITA, and no entity that is not treated as a partnership for federal income tax purposes is a partnership for purposes of the IITA…

Prior to the enactment of the Personal Property Replacement Income Tax (Replacement Tax), partnerships did not incur a tax liability under the Illinois Income Tax Act. As a result of the enactment of PA 81-1stSS-1, partnerships earning and receiving income in Illinois on or after July 1, 1979 are subject to Illinois Replacement Tax at the rate of 1.5% of net income.

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IITA § 502(d) requires every partnership with base income allocable to Illinois (per IITA § 305(c)) to file an information return setting forth "specific information", including the following: all items of income, gain, loss and deduction; the names and addresses of all partners or other persons who would be entitled to share in the partnership's base income if distributed; and the amount of each distributive share. The requirement to file an Illinois partnership return is not, therefore, contingent upon the filing of a federal partnership return. Additionally, every partnership which has Illinois net income or loss is required to file an IL-1065 with the Illinois Department of Revenue. REF: Sunshine Letter IT91-0011.

A partnership return is required to be filed with the Department on or before the 15th day of the fourth month following the close of the taxable year. (IITA § 505(a)(2)). However, 86 IAC § 100.5020(b) gives all partnerships an automatic 6-month extension of time to file. Also, when the partnership has been granted an extension or extensions of time to file its federal income tax return, the Department shall automatically extend the due date of the partnership return for an equivalent period with the filing of a copy of such extension or extensions with the Department. (IITA § 505(3)(b)).

See Chapter 21 for an in-depth discussion of Illinois automatic filing extensions.

Partnerships do not have to make estimated income tax payments, but may do so voluntarily in 2014 and subsequent years using the Forms IL-516 and IL-516-B. Partners, however, are required to include partnership income in their estimated tax computations, but, because the partnership income is deemed received by the partner on the last day of the partnership's taxable year, a partner whose tax year is the same as the partnership's might have no estimated tax obligation using the annualization method of computing his or her required installments and estimated or composite return payments made by the partnership may cover any liability to make estimated payments.

a) IRC § 761 Election

Check this box if you made an IRC § 761 election. ☐

IRC Section 761(a) allows an unincorporated organization, at the request of all its members, to be excluded from treatment as a partnership, if it is:

1) For investment purposes only and not for the active conduct of a trade or business,
2) For the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted, or
3) By dealers in securities for a short period for the purpose of underwriting, selling or distributing a particular issue of securities,

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if the income of the members of the organization may be adequately determined without the computation of partnership taxable income.

Section 100.9750(d)(1)(B) of the IAC supports the above in stating:

"An entity that makes an election under 26 USC 761(a) to not be treated as a partnership is not a partnership for purposes of the IITA"

If the partnership has elected out of partnership treatment, there is no Illinois filing requirement. For entities other than corporations and residents, Illinois returns are only required when there is a liability, and there won't be a liability.

If there is an agreement among the members that the organization be excluded from subchapter K, the organization must make the election, by attaching a statement to the federal Form 1065 for the first taxable year for which the exclusion is desired, by the extended due date for filing the partnership return.

If the election is made at the time of the formation of the organization, no IL-1065 would be required to be filed.

If the election is made subsequent to the formation of the organization and federal Form 1065 and IL-1065 filings, an IL-1065 should be filed in the year of the election checking the box electing out of partnership treatment, so that we know why they are discontinuing filing returns.

The Department would accept the federal filing status (electing out of partnership treatment) unless there is some reason to suspect a specific mistake or to conduct a general audit.

Partnerships that elect Section 761 treatment will not issue Schedules K-1-P, since the partnership does not exist for tax purposes. Nor will they withhold from nonresident partners.

Any income from the partnership will be reflected on the partner's returns.

The IRC § 761 election is also available for qualified joint ventures conducted by a husband and wife who file a joint return for the taxable year, effective for all taxable years beginning after December 31, 2006.

A qualified joint venture is defined by IRC § 761(f)(2) as:

> …any joint venture involving the conduct of a trade or business if –
> (A) The only member of such joint venture are a husband and wife,

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(B) Both spouses materially participate (within the meaning of section 469(h) without regard to paragraph (5) thereof) in such trade or business, and

(C) Both spouses elect the application of this subsection

Such joint venture shall not be treated as a partnership. All items of income, gain, loss, deduction, and credit shall be divided between the spouses in accordance with their respective interests in the venture. Each spouse shall take into account such spouse's respective share of such items on his or her own separate Schedule C as if they were attributable to a trade or business conducted by such spouse as a sole proprietor.

b) Audit Procedures

Taxable income of a partnership is defined by IITA § 203(e)(2)(H) as:

> ...taxable income determined in accordance with Section 703 of the IRC, except that taxable income shall take into account those items which are required by Section 703(a)(1) to be separately stated...

In auditing the IL-1065, it is imperative to verify all items reported, as well as tracing all items of income and modifications to the individual partner's federal and Illinois income tax returns. Form EDA-92, IL-1065 Auditor's Report, is completed to disclose adjustments proposed in the audit.

If the partnership is a non-filer and presents the auditor with signed original returns, copies should be retained for the audit file and the originals should be forwarded to Audit Planning in Springfield for processing. The statute of limitations will commence running on the date the auditor receives the signed returns. The taxpayer is no longer considered a non-filer.

If the proposed changes result in a no liability audit or a no liability year within the audit period, the only way to process any line change(s) is to complete an IL-1065-X Amended Partnership Replacement Tax Return, (for tax years prior to 2006 an IL-843 Amended Return or Notice of Change in Income) and have the taxpayer sign it. This is necessary because the taxpayer must be given the opportunity to agree or disagree with PROPOSED changes resulting from an audit. That does not occur in a no-liability year or audit because a Notice of Deficiency is issued only when there is an increase (or decrease) in the tax liability.

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If the audit findings create an underpayment or an overpayment, then the auditor must complete an EDA-92, IL-1065 Auditor's Report for Partnerships and accompanying IL-870 (for non-APT audits) and EDA-27.

c) Nexus Issues

A partnership or Subchapter S corporation that has nexus in Illinois creates nexus for its partners (general or limited) or shareholders even if those partners and shareholders are not unitary with the partnership or Sub-S. It states in 86 IAC § 100.9720(f):

> Application of the Joyce Rule. In determining whether the activity of a nonresident taxpayer conducted in this State is sufficient to create nexus for application of Illinois income tax or replacement tax, the principles established in Appeal of Joyce Inc., Cal. St. Bd. of Equal. (11/23/66), commonly known as the "Joyce rule," shall apply. Only activity conducted by or on behalf of the nonresident taxpayer shall be considered for this purpose. **Because the income of a partnership, a Subchapter S corporation or any other pass-through entity is treated as income of its owners, activity of a pass-through entity is conducted on behalf of its owners. Activity conducted by any other person, whether or not affiliated with the nonresident taxpayer, shall not be considered attributable to the taxpayer, unless the other person was acting in a representative capacity on behalf of the taxpayer.** [Emphasis added]

Example: Partnership A is an operating partnership owned 99% by Partnership B, a Delaware limited partner and 1% by Corporation C, the general partner. Partnership A filed an IL-1065 but did not owe any replacement tax because all of its income is subject to a subtraction modification for income distributed to entities subject to replacement tax. The two partners have no connection to Illinois other than through their ownership of Partnership A. The 99% limited partnership and 1% general partner owe replacement tax on its flow-through income from Partnership A since partnerships create nexus for their partners. Borden Chemicals and Plastics, L.P. v. IDOR, Cite: 312 Ill. App. 3d 35; 726 N.E.2d 73; 2000 Ill. App. LEXIS 84; 244 Ill. Dec. 477 (2000).

Although the Illinois partnership or S corporation creates nexus for the partner or shareholder, the Illinois partner or shareholder generally does not create nexus for the partnership or S corporation unless the partner or shareholder "was acting in a representative capacity on behalf of the taxpayer."

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Example: Corp A is headquartered in NY and purchases products from its foreign parent that are drop shipped to Corp A's distribution center in Illinois. However, all non-Illinois destination sales are actually made to Partnership B, which has no Illinois nexus and is owned 100% directly or indirectly by Corp A. Corp A drop ships the products from its Illinois distribution center to B's non-Illinois customers. Title to the goods passes to Partnership B at B's customer locations. Partnership B claims that it does not have Illinois nexus and therefore is not subject to Illinois' sales throwback provisions.

The auditor obtains a copy of the service contract between Corp A and Partnership B which shows that Corp A is responsible for storing the finished product "on behalf of" Partnership B at Corp A's Illinois distribution center. In addition, the auditor is able to document that there is a transfer of inventory from Corp A to Partnership B. Corp A is now acting as an agent of Partnership B and the inventory at Corp A's Illinois warehouse gives Partnership B nexus in Illinois and subjects B to Illinois throwback provisions on products shipped from Illinois to customers in states where B is not subject to tax.

d) Investment Partnerships

Investment partnerships are not subject to replacement tax nor do they have to file IL-1065 returns starting with taxable years ending on or after December 31, 2004. However, an investment partnership can elect to file the IL-1065. If they elect to file an Illinois return, then starting with 2006, the IL-1065 has a "check-the-box" on the front page indicating that it is an investment partnership. If they mark the box, then zeros are entered on all lines after the line for base income or net loss (taxable income net of modifications).

If the investment partnership is an Illinois filer, then it would report all of its income/loss to its partners on Schedule K-1-P. An investment partnership only completes Column A of Steps 3 and 4 of the Schedule K-1-P. Column B of the Schedule K-1-P is left blank leaving the partner to determine if any of the income should be reported to Illinois.

Investment partnerships are not required to withhold from nonresident partners under IITA § 709.5.

Note: See section below on Partners of Investment Partnerships for information on how partners report income from investment partnerships.

The definition of an investment partnership is found in IITA § 1501(a)(11.5) and further explained in 86 IAC § 100.9730. Under that regulation an investment partnership must meet ALL three of the following:

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1. At least 90% of the partnership's total assets must consist of:

   - Qualifying investment securities
   - Deposits at banks or other financial institutions
   - Office equipment and office space needed to carry on the business of the partnership

2. At least 90% of the investment partnership's income consists of interest, dividends, and gains from the sale or exchange of qualifying investment securities.

3. The partnership IS NOT a dealer of qualifying investment securities as "dealer" is defined in IRC § 475(c)(1).

   (Note: If partnership is trading its own account and sells securities on an exchange or to persons it does not deal with directly, the purchasers are not its customers, but customers of the brokers who bought from it. In that event the partnership will qualify as an investment partnership. IRC §475(c))

IITA § 1501(a)(11.5) and 86 IAC § 100.9730(b) list 12 items as "Qualifying Investment Securities":

1. Common and Preferred Stock
2. Bonds, debentures and other debt securities
3. Foreign and domestic currency deposits secured by federal, state, or local government agencies
4. Mortgage or asset-backed securities secured by federal, state, or local government agencies
5. Repurchase agreements and loan participations that are not characterized as loans
6. Foreign currency exchange contracts
7. Stock and bond index securities and futures contracts
8. Options for the purchase or sale of any of the securities, currencies, contracts, and financial instruments mentioned in items 1 through 7 above
9. Regulated futures contracts
10. Certain other commodities not described in IRC § 1221(a)(1)
11. Derivatives (See 86 IAC § 100.9730(b)(11))
12. A partnership interest in another partnership that is an investment partnership

(1) The 90% Tests

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The total assets test is the percentage of the qualifying assets as of the beginning of the taxable year, plus the percentage of qualifying assets as of the end of each month of the taxable year and computing the average of these percentages. The test is on a separate company basis as opposed to a unitary basis. Included in qualifying assets is the cost of office space and equipment necessary to carry on the activities of an investment partnership. Note that the statute does not provide for the inclusion of capitalized rents in the 90% test (Rents times 8 as in the calculation of the property factor).

In addition, it states in 86 IAC § 100.9730(d) Cost of Assets:

> … the cost of an asset shall be determined for federal income tax purposes without regard to depreciation or amortization of the asset, except that the cost of an asset shall include any accrued interest or discount, and shall be reduced by any premium amortization, that has been recognized in the computation of federal taxable income of the partnership and that is included on the partnership's balance sheet as of the date the cost of assets is determined.

The 90% gross income test is total sales minus cost of goods sold and minus the cost of any intangible asset sold or traded. In addition, the gross income for the test must be items included in base income subject to apportionment but would exclude the income from any one-time occasional sale of assets, such as the sale of equipment.

Example 1: A partnership owns a restaurant building in Illinois. The building is leased under a net lease arrangement under which the partnership receives gross rent only. The only expense of the partnership is depreciation. Under the definition of an investment partnership the building owned by the partnership does not meet the definition of “qualifying investment securities”. In addition, the cost of the building is not the cost of a qualifying asset for purposes of IITA § 1501(a)(11.5)(A)(i), nor is the rental income considered qualifying income for purposes of IITA § 1501(a)(11.5)(A)(ii).

Example 2: A partnership makes loans to its partners. The partnership does not qualify as an investment partnership because the partnership's loans to its partners would not be "debt securities" because they are not securities nor are they loan participations because no other lender is involved.

Example 3: Several partnerships operate as general partnerships, single member LLCs and S-Corps. Some elect IRC § 475 mark-to-market accounting to convert capital gains and losses into ordinary gain or loss

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treatment. Only entities characterized as partnerships for federal income tax purposes may be an "investment partnership". Subchapter S Corporations and single-member LLCs that elect corporate treatment (or that elect to be disregarded and are not owned by a partnership so that they are treated as part of the partnership) cannot qualify.

Example 4: An LLC has 86% of its assets in stocks and bonds. The only other asset is a life insurance policy on the life of one of the members. All the members are related individuals or related beneficiaries of trusts (father, sons, and trusts for the benefit of the sons.) The cost basis in the policy is equal to the premiums paid. All (100%) of the taxable income from the LLC is from the stocks and bonds. Insurance policies are not qualifying assets, so the LLC is not an investment partnership since the 90% asset test is not met.

See 86 IAC § 100.9730 for more information.

A "Investment Partnership 90% Tests" worksheet has been added to the IL-1065 folder in the APT Bundle for use in completing the 90% Total Asset and 90% Gross Income tests.

Partners of Investment Partnerships

Unless there is an integral relationship between the partner and the investment partnership as described below under Business Income Treatment of Income from Investment Partnerships, then IITA § 305(c-5) and 86 IAC § 100.3500(d)(1) treat income passed through from an investment partnership to its partners as nonbusiness income that is allocated to the state of residency if the partner is an individual, or to the state of commercial domicile if the partner is a corporation. Although the statute in IITA § 205(b) gives an effective date of an investment partnership as tax years ending on or after December 31, 2004, the statute on the partnership flow-through in IITA § 305(c-5) does not give an effective date. Therefore, the effective date on the partner flow-through is tax years of an investment partnership ending on or after July 30, 2004, which is the date that PA 93-840 was signed into law.

Example: An investment partnership has a fiscal year-end September 30, 2004 and is owned by non-resident individuals. It has to file an IL-1065 and is subject to replacement tax since its year ends prior to December 31, 2004; however, the income distributed to the nonresidents is nonbusiness income allocated to the state of residency, since the income was distributed from an investment partnership having a tax year ending on or after July 30, 2004.

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(3) Election to Treat All Income as Business Income

A partnership that meets the definition of an investment partnership under IITA § 1501(a)(11.5) and 86 IAC § 100.9730 must treat its income as nonbusiness income under IITA § 305(c-5). If an investment partnership files an IL-1065, it does not actually report the income as nonbusiness income but checks the box on the IL-1065 indicating that it is an investment partnership and enters zeros on all lines after base income thereby having the same effect as reporting the income as nonbusiness. Therefore, an investment partnership cannot make the election to treat all income as business income.

However, the partner of an investment partnership can make the business income election under 86 IAC §§ 100.3015(c) and 100.3500(d)(2). In that case the partner will include all of its income from an investment partnership as income subject to apportionment, but under 86 IAC § 100.3500(d)(3) none of the investment partnership's factors will flow up to the partner. See paragraph below for unitary partners.

e) Business Income Treatment of Income from Investment Partnerships

Normally the flow-through income from investment partnerships is treated by the partner as nonbusiness income and allocated to the partner's state of residency, if an individual, or to the state of commercial domicile with respect to corporations. In the case of a nonresident individual the income would be reported as non-Illinois income on the Schedule NR attachment to the IL-1040. In the case of any other non-resident partner the income/loss is eliminated from the partner's net income either as non-unitary partnership income/loss or as nonbusiness income, which on a 2013 IL-1120 is reported on Part 4, lines 24 and 25. There is no factor relief since all of the investment partnership's income or loss is eliminated from base income subject to apportionment.

However, there is an exception to the normal rule above. 86 IAC § 100.3500(d)(2) states that:

> Any income distributable to a nonresident partner shall be treated as business income … if such income is from investment activity:
>
> 1. that is directly or integrally related to any other business activity conducted in this State by the nonresident partner (or any member of that partner's unitary business group) (IITA § 305(c-5)(1));

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2. that serves an operational function to any other business activity of the nonresident partner (or any member of that partner's unitary business group) in this State (IITA § 305(c-5)(2)); or

3. where assets of the investment partnership were acquired with working capital from a trade or business activity conducted in this State in which the nonresident partner (or any member of that partner's unitary business group) owns an interest (IITA § 305(c-5)(3)).

This allows the income received from the investment partnership to be treated by the nonresident partner as business income, as long as the above tests are met, so that the income or loss is included in net income subject to apportionment. However, the partner does not flow up any factors from the investment partnership if it is unitary because the income remains nonbusiness income in the hands of the investment partnership. Nonbusiness income does not generate any apportionment factors either for the partnership or the partner.

Example 1: In 2008 an investment partnership is owned 99% and 1% respectively by two members of a unitary business group of C-corps. Not only is the investment partnership unitary with its partners but also invests substantial capital through the unitary group. Whether or not the investment partnership files an IL-1065, its income or loss is included in Illinois base income of the unitary group, because it is included in federal taxable income, but the unitary group does not flow up any factors from the investment partnership (i.e. no sales/income items are included in the apportionment factor, both everywhere and Illinois.)

(1) Investment Clubs

For federal income tax purposes, an investment club is considered a partnership. However, pursuant to IRC § 761(a)(1), an unincorporated organization used for investment purposes only, and not for the active conduct of a trade or business (i.e., an investment club), may “opt out” of partnership treatment, in whole or in part, at the election of all of its members. If an investment club makes the Section 761(a) election according to the procedures in 26 CFR § 1.767-2(b), the organization will not be required to file federal Form 1065 and will not be treated as a partnership for Illinois income tax purposes, either. An investment club must file Form IL-1065 if it has not elected to opt out of partnership treatment under IRC § 761(a).

(2) Lottery Partnerships

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Effective November 30, 1989, any partnerships which have been formed solely to play the Illinois State Lottery will not be responsible for filing Form IL-1065 and paying replacement tax on their earnings. REF: Sunshine Letters IT90-0120 and IT90-0198.

The individual partners report the income on their IL-1040 return including nonresident individuals. Ref: IITA § 303(e). Illinois income taxes withheld on Form W2-G on payments to the partnership may be claimed by the individual partners.

f) Form IL-1065

Form IL-1065 underwent a major revision in 2006 to make it easier to complete and process, although the computation of income subject to tax remains the same. In addition, Schedule M was created in 2006 that itemizes most of the addition and subtraction modifications.

A partnership with Illinois business income must send each partner a Schedule K-1-P, along with the Schedule K-1-P(2) Partner Instructions, to report each partner's share of income, deductions, credits, and recapture amounts.

(1) Portfolio Income

Portfolio income consists of interest, dividends, royalties and any other income from intangible assets. Portfolio income is business income apportionable to non-resident partners based on the partnership's Illinois factor if it is business income of the partnership or if the partnership made the election to treat all income as business income on its IL-1065.

Example 1: A partnership in Chicago is owned 50% by a Subchapter S corporation in Michigan and 50% by a nonresident individual in Indiana. The partnership, which is non-unitary with the Sub S, has an Illinois apportionment factor of 75% and reports $1 million in interest income on federal Schedule K-1, Part III, line 5. The partnership files its IL-1065 and checks the box in Step 1 that elects to treat all income as business income; so the interest income will be business income for both partners under 86 IAC § 100.3015(c). The partnership will send each partner a Schedule K-1-P showing $500, 000 ($1 million x 50%) in Step 4, Column A, line 23, and $375,000 ($500,000 x .75) in Column B. The Indiana individual will include the interest income, along with other business income of the partnership, on Schedule NR, Step 3, Line 15, Columns A & B. The Michigan Sub S will treat the income as business income from a nonunitary partner, and include

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the amount apportioned to Illinois by the partnership as Illinois income.

If the partnership determines that the portfolio income is nonbusiness income, then it will be allocable (not apportioned) to the partners under IITA § 305(b) and 86 IAC § 100.3500(c). Each partner will allocate the non-business interest income by applying IITA §§ 301 and 303 and 86 IAC §§ 100.3220 and 100.3300.

Example 2: Same facts as above except that the partnership has determined that the $1 million in interest income is nonbusiness (and the auditor allows it as nonbusiness). Schedule K-1-P for each partner will show $500,000 in Step 3, line 10, Column A only. Nonbusiness interest and dividend income is allocable to the state of residency for non-resident individuals and to the state of commercial domicile of a corporation or partnership under IITA § 301(c)(2) and 86 IAC § 100.3300(b)(2).

(2) Unmodified Base Income

Taxable income of a partnership is defined by IITA § 203(e)(2)(H) as:

> ...taxable income determined in accordance with Section 703 of the IRC, except that taxable income shall take into account those items which are required by Section 703(a)(1) to be separately stated...

Computation of the partnership's taxable income begins with the ordinary income (loss) reported on the federal return. Other items of income, loss and deductions that are required to be separately stated for federal purposes are then taken into account in Steps 2 and 3 of the IL-1065 (for tax years 2006 and after, Part 1A for years through 2005.) in calculating unmodified base income. Those items are obtained from Schedule K of federal Form 1065

Under 86 IAC §100.2405(c)(8)(A) the following pass-through items on the federal Schedule K are included or excluded from unmodified base income on the IL-1065 Steps 2 and 3 (Part 1A, Lines 2 and 4 for years prior to 2006):

- Gains and losses from sales or exchanges of capital assets
- Gains and losses from sales or exchanges of property described in IRC section 1231 (relating to certain property used in a trade or business and involuntary conversions);

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- Charitable contributions under IRC § 170(c);
- Dividends entitled to capital gains treatment under IRC § 1(h)(11) or to the corporate dividends-received deduction under part VIII of subchapter B of the IRC;
- Taxes for which the foreign tax credit may be allowed under IRC § 901, paid or accrued to foreign countries and to possessions of the United States; and
- Any other items of income, gain, loss, deduction or credit as listed in 26 CFR 1.702-1.

IRC § 965 Transition Tax

In 2017, Congress passed the Tax Cuts and Jobs Act of 2017. The law introduced new provisions that changed which earnings, profits, and deductions owners of controlled foreign corporations (CFC) must report. Under the old rules, US taxpayers were generally taxed on all income whether earned in the US or abroad, but foreign income earned by a foreign subsidiary of a US corporation would not be subject to US tax until it was “repatriated” to the US as dividends. So, US taxpayers could defer US taxes on net income by keeping the assets in a foreign company. The new law removes this ability and requires US taxpayers to pay tax on previously untaxed assets. IRC § 965 requires US shareholders as defined by IRC § 951(b) to pay a transition tax on untaxed foreign earnings of certain specified foreign corporations going back to 1987, as if those earnings had been repatriated to the U.S. The transition tax effectively bridges the old rules with the new by taxing certain previously untaxed foreign income.

This new section applies to the last taxable year of specified foreign corporations beginning before 01/01/2018, and the tax is includible in the US shareholder’s tax year in which or with which the specified foreign corporation’s year ends.

Illinois Modification

For 2017, the IRC § 965 income is reported to the IRS on a statement separate from the federal income tax return. Due to the nature of the separate statement, this income may not be included in the federal taxable income. However, it must be included when determining Illinois Base Income. If the income was not included in the federal taxable income, an Illinois taxpayer must make the appropriate modifications.
Partnerships are required to make the following modification for tax year 2017

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	IRC 965 Transition Tax Statement	Form IL-1065
IRC § 965 (a)	Line 1	Step 2, Line 6
IRC § 965 (c)	Line 3	Step 3, Line 11

Attach the Statement to your return.

Any IRC Section 965 income or deduction passed through to partners must be identified by attaching a statement to Schedule K-1-P.

For 2018 tax years and after, the foreign earnings are included in the federal taxable income.

Note: IITA § 203(e)(2)(H) permits a deduction without application of the federal limitations imposed on how much the partner can deduct, such as the charitable contributions deductions.

Note: See 86 IAC § 100.2405(c)(8)(C) for information on special rules covering oil and gas partnerships and the discharge of indebtedness, if applicable to the audit.

Refer to Exhibit A for an example of a 2017 IL-1065 line verification.

(3) Modifications

Prior to the enactment of the Personal Property Replacement Income Tax, partnerships incurred no income tax liability in Illinois. PA 81-1st SS-1 (effective September 19, 1979) added current IITA § 203(d).

If the taxpayer claimed any modifications not listed here, refer to the IL-1065 or Schedule M instructions for that year.

(a) Additions

The IL-1065, Step 4 and Schedule M, Step 2 (Schedule M is for 2006 and after) lists the following addition modifications relating to partnerships.

Refer to Exhibit B and Exhibit C for an example of a 2017 IL-1065 and Schedule M addition modification cite reference.

(i) Federally Tax-Exempt Interest

(IITA § 203(d)(2)(A))

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This includes income, which is recorded on the books but not included in the tax return and can be verified through a breakdown of the amount recorded on Schedule M-1 Line 6a (for tax years 1992 and forward) of federal Form 1065. This amount is reported in Step 4 of IL-1065.

Other income exempt from Illinois income tax that is also federally tax-exempt so the income is not included in federal taxable income includes:

- Bonds issued by the governments of Guam, Puerto Rico, Virgin Islands, American Samoa and Northern Mariana Islands
- Mutual Mortgage insurance fund bonds

Since this income is not presently included in federal taxable income, under Illinois law, it must be added back to federal taxable income and then claimed as a subtraction.

This amount is reported on Schedule M, Step 2

For a detailed discussion of this modification, refer to Chapter 24.

(ii) Illinois Income and Replacement Tax Deducted

(IITA § 203(d)(2)(B))

This is the amount of replacement tax subtracted from ordinary income of the partnership and can be verified by obtaining a breakdown of the deductions for taxes on page one of federal Form 1065.

This addition modification passes through to nonresident partners which must report it as a flow-through addition modification (86 IAC § 100.2450(b)). A non-resident individual would include the flow-through on Schedule NR, Step 4, under “Other Additions” (Line 40, Column A & B, for tax years 2009 and forward; line 42 for tax years 2005 thru 2008. For tax years 2007 and prior the line number varied) which would be based on the amounts reported to the partner on Schedule K-1-P, Step 5, line 33, Column A & B (since the inception of the K-1-P in 1998). Although individuals are not subject to replacement tax, IITA § 203(a)(2)(B) requires an addition modification for any deduction for taxes paid under the IITA. The deduction for replacement tax that flows through from a partnership is taken into account in computing adjusted gross income of an individual partner and must be added back.

For a detailed discussion of this modification, refer to Chapter 24.

(iii) Guaranteed Payments to Partners

(IITA § 203(d)(2)(C))

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Provides an addition modification for "The amount of deductions allowed to the partnership pursuant to IRC § 707(c) in calculating its taxable income." IRC § 707(c) relates to guaranteed payments made to partners. REF: Sunshine Letter IT90-223. These payments are a deduction from income on page one of federal Form 1065. This amount is therefore verified from the applicable line on page one of federal Form 1065. Guaranteed payments under IRC § 707 are just distributions of partnership earnings but are deducted in computing taxable income of a partnership because doing so simplifies the computation of all amounts of income distributable to partners. The addition modification is made so that this distribution of income is included in the net income of the partnership. Guaranteed payments are included in the federal taxable income or adjusted gross income of partners, so the addition does not flow through to the partners.

A partnership may have two types of partners, capital partners and income partners.

- Capital partners have a percentage of ownership in the partnership and receive a distribution of the partnership income based on that percentage. Capital partners may also receive guaranteed payments.
- Income partners do not have a percentage ownership in the partnership but instead receive guaranteed payments based on their employment contract and may also receive annual bonuses based on their performance.

Effective November 17, 2003 86 IAC § 100.3500(a)(4) was added which states:

> Except as provided in this subsection (a), all items of base income of a partner that are derived from the partnership shall be allocated or apportioned pursuant to this Section, including all items required to be separately stated to the partner under IRC section 703(a)(1), all guaranteed payments under IRC section 707(c), and all addition and subtraction modifications, but excluding items described in IRC section 707(a).

Prior to the regulation change it was the Department's position that we would not apportion to Illinois any guaranteed payments issued to non-resident income partners. However, the regulation change above is effective for all years within statute; therefore, all guaranteed payments are subject to apportionment for nonresidents.

All resident partners, capital partners and income partners will include 100% of their guaranteed payments in Illinois base income and then attach

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Schedule CR to their IL-1040 to claim credit for any taxes paid to other states.

Nonresident capital partners and income partners will apportion their guaranteed payments along with their distributive share of net income to Illinois based on the apportionment factor of the partnership.

(iv) Capital Gains Addition

(IITA § 203(d)(2)(D))

Provides for an addition modification for "an amount equal to the amount of the capital gain deduction allowable under the IRC, to the extent deducted from gross income in the computation of taxable income."

For tax years prior to December 31, 1987, IITA § 203(d)(2)(B) allowed an addition modification for "an amount equal to the amount of the deduction allowable under IRC § 1202, to the extent deducted from gross income in the computation of taxable income". At the time, IRC § 1202 allowed a partial deduction from taxable income for income received from capital gains.

Since IRC § 1202 had been repealed for tax years beginning after December 31, 1986, there was no longer a necessity for the addition modification, which was repealed by PA 85-731.

(v) Federal Bonus Depreciation

(IITA § 203(d)(2)(D-5))

For a detailed discussion of this modification, refer to Chapter 24.

The amount of the modification is calculated on IL-4562 and reported on IL-1065, Step 4.

(vi) Bonus Depreciation – Reversal of Subtraction on Disposition or End of Depreciable Life

(IITA § 203(d)(2)(D-6))

For a detailed discussion of this modification, refer to Chapter 24.

The amount of the modification is calculated on IL-4562 and reported on IL-1065, Step 4.

(vii) Related Party Expenses

(IITA §§ 203(d)(2)(D-7), (D-8))
(86 IAC §100.2430)

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For a detailed discussion of this modification, refer to Chapter 24.

Related party expense modification is calculated on the IL Schedule 80/20 and reported on IL-1065, Step 4 and flows-through to the partner on Schedule K-1-P, Step 5.

(viii) Captive Insurance Companies

(IITA § 203(d)(2)(D-9))

For a detailed discussion of this modification, refer to Chapter 24.

The modification is calculated on Schedule 80/20 and reported on IL-1065.

(ix) Section 218 College Prepaid Tuition Credit

(IITA § 203(d)(2)(D-10))

This modification applies to taxpayers who, for tax years ending on or after December 31, 2009 and on or before December 30, 2020, claim a credit for making a matching contribution to a specified college savings plan.

The credit is calculated on Schedule 1299-A. Each partner's share of the credit is reported on Schedule K-1-P, Line 52i.

(x) Domestic Production Activities Deduction

(IITA § 203(d)(2)(D-11))

Effective for tax years ending on or after December 31, 2017, requires an addition for the federal deduction amount allowed under IRC Section 199 as reported on Line 25 of federal Form 1120.

The amount of the addition is reported on Schedule M.

(26 U.S. Code § 199 – repealed. Pub. L. 115-97, title I, § 13305 (a), Dec. 22, 2017, 131 Stat. 2126) for tax years beginning after December 31, 2017

(xi) Business Expense Recapture

(IITA § 203(e)(3)
(86 IAC § 100.2405(d))

No recapture is required relating to investment partnerships. (86 IAC § 100.2405(d)(2)). If the partnership, subchapter S corporation, and trust or

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estate is required to recapture business expenses, then the partner, shareholder in a subchapter S corporation, or beneficiary of a trust or estate is also required to report the recapture, unless that partner, shareholder or beneficiary elected to treat all income as business income in the subsequent year. (86 IAC § 100.2405(d)(3))

The amount to be recaptured is calculated on Schedule NB and reported on Schedule M.

For a detailed discussion of this modification, refer to Chapter 24.

(xii) Distributive Share of Additions

If the partnership is a partner in another partnership or a beneficiary of a trust or estate, the partnership's distributive share of any additions from any of these entities must be added to the computation of base income. Each of the entities is required to provide the partnership with a federal Schedule K-1, and if the partnership is an Illinois filer, Schedule K-1-P will be sent to each partner indicating the distributable share allocable to Illinois. If the partner is another partnership, then the flow-through addition modification will be reported on the IL-1065 in Step 4.

(xiii) The Amount of Loss Distributable to a Partner Subject to Replacement Tax

Refer to the corresponding subtraction modification Share of Income Distributable to a Partner Subject to Replacement Tax.

(xiv) Lloyd's Plan of Operation Loss

(IITA § 502(f))

Add back any loss that was included in your adjusted gross income from a Lloyds plan of operation and was reported on Form IL-1023-C (for tax years ending prior to December 31, 2014) or IL-1065 (for tax years ending on or after December 31, 2014).

Income tax on a Lloyd's Plan of Operation income is taxed separately from the taxpayer's other income and paid on the taxpayer's behalf by Lloyd's. Therefore, if Lloyd's losses are included in the taxpayer's FTI (or AGI), it must be added back.

This addition modification is reported on Schedule M.

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(b) Subtractions

The IL-1065, Step 5 and Schedule M (Sch M is for 2006 and after) lists the following subtraction modifications relating to partnerships.

Refer to Exhibit D and Exhibit E for an example of a 2017 IL-1065 and Schedule M subtraction modification cite reference.

(i) Valuation Limitation Subtraction

(IITA § 203(d)(2)(E))

Provides a subtraction modification for the valuation limitation amount, which excludes appreciation attributable to the period prior to August 1, 1969. It is computed on Form IL-1065, Schedule F. Although Replacement Tax on Partnerships began on July 1, 1979, the computation for the Valuation Limitation amount is based on August 1, 1969, the effective date of the Illinois Income Tax. REF: Chen et al., Partners in Monroe-Franklin Properties, Illinois Appellate Court, Cook County, March 30, 1990.

For a synopsis of the Chen case and a complete case citation, refer to Chapter 49 (Old 37).

(ii) Illinois Income Tax Refunds

(IITA § 203(d)(2)(F))

When examining this subtraction modification, it is important to verify the amount of the refund that is actually included in the computation of federal taxable income.

See 86 IAC § 100.2450 for more information.

For a detailed discussion of this modification, refer to Chapter 25.

(iii) Exemptions by Virtue of Statutes or Constitution

(IITA § 203(d)(2)(G))
(86 IAC §100.2470)

Interest income of a partnership is reported on Schedule K as portfolio interest. In order to verify this subtraction, the taxpayer's supporting workpapers should be examined. If this is not sufficient, the bond ledger should also be reviewed. (Some taxpayers may refer to this as the bond account, bond portfolio, etc.) The interest subtracted must be allowable per

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Publication 101 and 86 IAC § 100.2470. Finally, it must be verified that the income has actually been included in federal taxable income.

Note: Federally exempt state and municipal interest is subject to an addition modification under IITA § 203(d)(2)(A), but any exempt state and municipal interest listed in 86 IAC § 100.2470(f) is allowed as a subtraction modification under IITA § 203(d)(2)(G) and claimed on the line for U.S. government interest. The auditor should verify that any exempt Illinois state and municipal interest was not received through a mutual fund. Although U.S. Government interest received through a mutual fund is exempt, interest on exempt state and municipal interest received through a mutual fund is not exempt under 86 IAC §100.2470(d).

Income from the following items will be subtracted on Schedule M, Step 3 only if they were required to be added back in Step 2 on Schedule M:

- Bonds issued by the governments of Guam, Puerto Rico, Virgin Islands, American Samoa and Northern Mariana Islands
- Mutual Mortgage insurance fund bonds

For a detailed discussion of this modification, refer to Chapter 25.

(iv) Personal Service Income/Reasonable Allowance for Compensation Paid

(IITA § 203(d)(2)(H))

Allows a partnership, for purposes of computing its personal property tax replacement income tax under Section 201(c) and (d), the following subtraction modification:

> Any income of the partnership which constitutes personal service income as defined in Section 1348(b)(1) of the Internal Revenue Code (as in effect December 31, 1981) or a reasonable allowance for compensation paid or accrued for services rendered by partners to the partnership, whichever is greater.

The IL-1065 instructions state that the subtraction is the greater of:

- Your PSI as defined in the now-repealed IRC § 1348(b)(1); or
- A reasonable allowance for compensation paid or accrued for services rendered by partners to you.

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APPLICABLE FEDERAL STATUTES AND REGULATIONS

Section 1348(b)(1) of the Internal Revenue Code, as in effect on December 31, 1981, provided that "personal service income" means:

> Any income which is earned income within the meaning of section 401(c)(2)(C) or section 911(b) or which is an amount received as a pension or annuity which arises from an employer-employee relationship or from tax-deductible contributions to a retirement plan.

Section 911(b) of the Internal Revenue Code (as in effect on December 31, 1981) deals with income earned by an individual for personal services in a foreign country and provides:

> For purposes of this section, the term "earned income" means wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered earned income.

Note that Section 1348(b)(1)(A) provided that:

> For purposes of this subparagraph, section 911(b) shall be applied without regard to the phrase ", not in excess of 30 percent of his share of net profits of such trade or business".

Regarding the Code definition of earned income, Treasury Regulation § 1.911-2(b)(3) provided as follows:

> Earned income includes all fees received by a taxpayer engaged in a professional occupation (such as a doctor or lawyer) in the performance of professional activities. Professional fees constitute earned income even though the taxpayer employs assistants to perform part or all of the services rendered, provided the taxpayer's patients or clients look to the taxpayer as the person responsible for the services.

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Treasury Regulation § 1.1348-3(a)(2) provided:

> The entire amount received as professional fees shall be treated as earned income if the taxpayer is engaged in a professional occupation, such as a doctor, dentist, lawyer, architect or accountant, even though he employs assistants to perform part or all of the services, provided that the patients or clients are those of the taxpayer and look to the taxpayer as the person responsible for the services performed.

Effective December 18, 2018 the Department adopted Regulation 100.2850 Subtraction Modification for Personal Service Income or Reasonable Allowance for Compensation to Partners (IITA Section 203(d)(2)(H)) to provide guidance on what amounts qualify for the PSI/RC subtraction under IITA 203(d)(2)(H).

GENERAL INFORMATION – THE DEDUCTION

IITA Section 203(d)(2)(H) states that the subtraction modification is equal to the greater of any income which constitutes personal service income or a reasonable allowance for compensation paid or accrued for services rendered by partners to the partnership.

Both prongs (Personal Service Income & Reasonable Compensation) will need to be evaluated.

PERSONAL SERVICE INCOME (PSI)

Only an individual (or grantor trust or estate in the case of income in respect of a decedent) may receive personal service income.

If the partnership is a business performing only personal services (with little to no capital), then the distributive share and guaranteed payment of the individual (or grantor trust or estate in the case of income in respect of a decedent) are included in the subtraction for personal service income.

A partnership that performs only personal services can include accounting, architecture, actuarial science, consulting, engineering, health, law or the performing arts.

When a partnership incurs a loss from a trade or business (as reflected on Line 1, IL-1065), it does not have personal services income.

If the loss is shared by all partners, then there is no increase in the partner's capital account balance for the taxable year, so there can also be no subtraction for reasonable compensation.

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This is not changed even if the partnership makes distributions to the partners during the taxable year.

If the partner received a guaranteed payment, they would be allowed a subtraction for the amount of the guaranteed payment.

If, after reviewing the reported deduction, applying the above guidance and requesting a detailed computation of the deduction from the taxpayer, Auditor is unable to determine if the amount of the deduction claimed is appropriate, the following calculation may be performed.

PSI Calculation

For each tax year, calculate the percentage of service income. This financial information comes from the Form 1065 Schedule K and attached statements, if applicable.

(Note: Calculation is service income (ordinary income from the US 1065) divided by total income (service income plus all other income from the US Schedule K).

Management Fees	$7,484,259
Rental Income	$0
Interest	$71
Dividends	$43,068
Royalties	$0
Short Term Cap Gain	$0
Long Term Cap Gain	$24,865,939
1231 Gain	$0
Other Income	$0
Total	$32,393,337

Ordinary Income	$7,484,259	=	23.10%
Total Income	$32,393,337		

For each tax year, calculate Total IL Income without regard for the Subject to Replacement Tax (SRT) deduction for the PSI/RC deduction.

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Income after Add. Mods	$27,520,242
Sub. Mods other than PSI & Sub to RT	$0
Total Income	$27,520,242

For each tax year, multiply the Total IL Income times the percentage of service income.

Total Income	$27,520,242
Service Income %	23%
	$6,358,364

For each tax year, multiply the above number by the ownership percentage NOT subject to replacement tax (partnership ownership percentage from IL-1065 Schedule B). This is the potential PSI deduction, **if it is greater than the amount allowable for RC.**

	$6,358,364
Ownership % not subject to RT	99.98%
PSI not subject to RT	$6,357,092

***Percentage of Service Income Calculation*:**

Management Fees	$7,484,259
Rental Income	$0
Interest	$71
Dividends	$43,068
Royalties	$0
Short Term Cap Gain	$0
Long Term Cap Gain	$24,865,939
1231 Gain	$0
Other Income	$0
Total	$32,393,337

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Ordinary Income	$7,484,259	=	23.10%
Total Income	$32,393,337		

PSI Deduction Calculation:

Income after Add. Mods	$27,520,242
Sub. Mods other than PSI & Sub to RT	$0
Total Income	$27,520,242
Service Income %	23%
	$6,358,364
Ownership % not subject to RT	99.98%
PSI not subject to RT	$6,357,092

REASONABLE COMPENSATION FOR SERVICES (RC)

The allowance for reasonable compensation is equal to the sum of the distributive shares of all partners who render services to or on behalf of the partnership of the income of the partnership, to the extent that the distributive share would have been allowed as a deduction to the partnership under 26 USC 162 (IAC § 100.2850(c)).

26 CFR 1.162-7(b)(3) limits the deduction for compensation for services to a reasonable allowance:

"it is, in general, just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances."

Per Legal, in other words, what would the partner's salary be if one could be paid?

IAC § 100.2850(c)(1)

…the amount allowed under this subsection… with respect to any partner may not exceed the increase, if any, in the capital account balance of the partner for the taxable year of the partnership in which the subtraction is claimed…without regard to contributions of money or property by the partner and without regard to distributions of money or property to the partner, but including a guaranteed payment made to the partner.

Increase in Capital Account Balance

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If the Partnership reports book capital under 26 USC 704 Partner's distributive share (verified by taxpayer checking the box for "Section 704(b) book" on Schedule K-1, Section L), then the subtraction modification would be limited to the increase reflected on Schedule K-1, Section L. If the partnership reports tax capital, GAAP, or something else, then the information in Section L may not reflect the limitation.

Independent Investor Test

The taxpayer may establish a presumption of reasonableness under the "independent investor test". The premise behind the independent investor test is that an independent investor will demand a certain level of return on investment. If the return received is at or above that level, the compensation being paid by the entity is presumptively reasonable.

In Exacto Spring Corp. v. Commissioner, 196 F.3d 833 (7th Cir. 1999), the court held that where an amount claimed as compensation for services rendered satisfies the "independent investor test" there arises a rebuttable presumption that such compensation is reasonable and therefore deductible under 26 USC 162(a)(1). Accordingly, where income of the partnership is allocated to partners in such amounts as to result in a satisfactory return on partnership capital, a rebuttable presumption shall arise that any remaining amount of income allocated to partners for services actually provided to the partnership is a reasonable allowance and therefore deductible under this Section. (See also, Menard, Inc. v. Commissioner, 560 F.3d 620 (7th Cir. 2009); Mulcahy, Pauritsch, Salvador & Co. Ltd. v C.I.R., 80 F.3d 867 (7th Cir. 2012) ("When a thriving firm that has nontrivial capital reports no … [taxable] income, it is apparent that the firm is understating its tax liability".)

It is up to the taxpayer to establish that a presumption of reasonableness arises under the independent investor test, not for us to calculate it.

Auditors can ask for an allocation between return on capital versus labor and support for why the allowance is reasonable.

The Department may rebut the taxpayer's reported reasonable compensation showing the amount claimed exceeds a reasonable amount, that was the result of extraneous factors, such as:

- An unexpected discovery of oil under the company's land,
- Or that the company intended to pay the owner/employee a disguised dividend (rather than salary);
- Partner does not work for the partnership;
- Conflict of interest;

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- Relation of partner's compensation to that of other partners in the partnership;
- Economic conditions.

If the partnership's trade or business incurs a loss (as reflected on Line 1, IL-1065), the partnership may have investment income that could support a subtraction for reasonable compensation.

THE PARTNERSHIP

Understand what trade or business your partnership is conducting. Is it strictly a personal services business or is capital a material income-producing factor?

THE PARTNER(S)

A. Analyze the partner(s) on the IL-1065, Schedule B

1. Partners that have the box in Section B, Column D checked are not eligible for the subtraction. Income distributed to these entities is subtracted from partnership income as Subject to Replacement Tax on the IL-1065. As such, the partnership is allowed a subtraction modification under IIA § 203(d)(2)(I). (Individuals, estates, or grantor trusts and other disregarded entities whose grantors or owners are individuals or estates are **not** subject to this tax.)

2. A Partner who is an individual (or grantor trust or estate in the case of income in respect of a decedent), may not be allowed the deduction if the partner is NOT providing a service that is generating income for the partnership. For example: a non-participating spouse who has a partnership interest but does not provide any services to the partnership. [IAC § 100.2850(c)]

3. A Partner who is an individual (or grantor trust or estate in the case of income in respect of a decedent), may be allowed the deduction if the partner IS providing a service that is generating income for the partnership. The partnership income needs to be analyzed, as well as, the services the partner provides to the partnership.

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B. Determining whether the partner is acting in his capacity as a partner or as an unrelated party (26 CFR §1.707-1)

Transactions in which the partner is acting as an unrelated party:

- Loans of money or property by the partnership to the partner or by the partner to the partnership
- Sale of property by the partner to the partnership
- The purchase of property by the partner from the partnership
- The rendering of services by the partnership to the partner or by the partner to the partnership
- Where a partner retains the ownership of property but allows the partnership to use such separately owned property for partnership purposes (i.e. to obtain credit or to secure firm creditors by guaranty, pledge, or other agreement)

When a partner is acting in a capacity as other than a partner, the partnership is allowed a deduction in the computation of its taxable income, and therefore no PSI/RC deduction may be taken for that partner.

C. GenTax Research

SSN in Multiple Pships/Scorps
This report will show what IL pass-through business an individual is a partner in and receives a K-1.

Under **Managers-Report-Report List**
Type “SSN” in the search line, ENTER
Select “SSN in Multiple Pships/Scorps”

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[redacted]

[redacted]

Type Partner “SSN” in box, ENTER

[redacted]

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A list of FEINs will appear (if any) that show what other businesses the partner is associated with and their filing periods.

PARTNERSHIP INCOME

Auditor needs to determine what kind of income the partnership has reported. The partnership may report earned income, passive income, or both. Only "earned income" may be used in determining the personal services income deduction. If the partnership sells property, then capital is likely material, and only that portion of the income attributable to services will be considered "earned income."

To determine the type of income, review the taxpayer's Form 1065. If additional documentation is needed for review, it is noted.

- Document required – Form 1065, pages 1-5 with the federal K-1s issued; Partnership agreement

Form 1065, Line 3-Gross Profit: The partnership is either providing a service or selling a tangible item. It is likely that the partner(s) is/are providing some type of service to the partnership.

Form 1065, Line 4-Ordinary Income from Other partnerships/estates/trusts: The partnership is receiving this income from another entity. The auditor needs to explore whether the partner(s) provides a service in generating that income. Only the portion of the income attributable to services will be considered "earned income" and includable in the deduction for PSI.

- Documents required – K-1(s) issued to taxpayer by every entity included in this amount; Partnership/Management Agreement between Partnership receiving the income and the partnership flowing the income to the partnership being audited.

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Form 1065, Line 5-Net farm profit/loss: The partnership most likely owns a farm. The auditor will need to determine if the partner(s) is the person actually farming or if the farm is under the management of another.

- Document required – Form 1040, Schedule F

Form 1065, Line 6-Net gain/loss for Form 4797 (Sale of Business Property): A determination needs to be made if the property was used in the generation of income. The auditor needs to determine if the gain/loss will be included in the deduction calculation. Includable only in the calculation for reasonable compensation.

- Document required – Form 4797

Form 1065, Line 7-Other income: The auditor needs to obtain the statement explaining the figure on this line. The auditor needs to explore whether the partner(s) provide service in generating that income.

- Document required – Statement that should have been attached to Form 1065

Form 1065, Schedule B, Line 2 & 3b: Note how these questions are answered.

Form 1065, Schedule K, Line 1-Ordinary business income (loss) – If amount is zero or a loss the partnership does not have personal services income. Refer to discussion of Personal Service Income and Reasonable Compensation above for further clarification.

Form 1065, Schedule K, Lines 2, 3a-Rental income/loss: The partnership typically owns commercial or residential rental property. The auditor needs to determine if the partner(s) provide service in generating that income.

- Documents required – Form 8825 for each rental property owned by the partnership; Partnership/Management Agreement

Form 1065, Schedule K, Line 4-Guaranteed payments: If there is an amount here, there should be an addition on the IL-1065. The deduction may be limited to this payment amount depending on the Partnership/Management Agreement

- Documents required – Partnership/Management Agreement

Form 1065, Schedule K, Line 5-Interest Income: This is typically passive income. Partner(s) do not perform any service to earn this type of income. It is usually earned on investments or other such types of assets.

- Document required- If “Statement attached” listed, obtain it

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Form 1065, Schedule K, Lines 6a, 7-Dividends, Royalties: This is typically passive income. Partner(s) do not perform any service to earn this type of income. It is usually earned on investments or other such types of assets.

- Document required-If "Statement attached" listed, obtain it

Form 1065, Schedule K, Lines 8, 9a, 10-Capital gain/loss: Amounts reported on these lines are not "earned income" and therefore cannot be included in the subtraction for PSI but can be used in the RC subtraction.

Form 1065, Analysis of Income: Review this table to see how the taxpayer reports which of its partner(s) are passive versus active in the partnership and general versus limited partner(s).

Analysis of Net Income (Loss)

1	Net income (loss). Combine Schedule K, lines 1 through 11. From the result, subtract the sum of Schedule K, lines 12 through 13d, and 16l	1	70,890.

2 Analysis by partner type:	(i) Corporate	(ii) Individual (active)	(iii) Individual (passive)	(iv) Partnership	(v) Exempt organization	(vi) Nominee/Other
a General partners						
b Limited partners			4,785.			66,105.

Just because partners are considered limited or inactive does not mean they do not have a separate employee relationship with the partnership that would allow them personal service income.

- Document required – Partnership Agreement; Any other contract or agreement

Once the auditor has determined the type(s) of income, a PSI and RC analysis needs to be completed, to determine which is larger.

ADDITIONAL GUIDANCE

A. A distribution by the partnership subject to 26 USC 731 (gain or loss on distribution) is treated as a return of capital and/or gain from the sale or exchange of the partnership interest of the distributee partner, and therefore, in no event may a distribution be included in the amounts computed under subsections (b) and (c). (IAC § 100.2850(a)(2)(B))

B. No amount may be deducted by the partnership for the transfer of a partnership interest in connection with the performance of services. (IAC § 100.2850(a)(3)(B)

C. Self-Employment Income (Schedule K Line 14a) is not reflected in the calculation of PSI or RC. Self-employment income is not included in any of the rules or regulations for calculating personal service income or a reasonable allowance.

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D. If all the partnership income is portfolio income (interest, dividends, royalties, etc.) this is NOT earned income and therefore cannot be included in the personal services calculation but can be included in the calculation for reasonable compensation.

E. Auditor's should familiarize themselves with the court cases cited in the new regulation (IAC § 100.2850) to learn about how to apply the PSI/RC subtraction.

- Estate of Tilton, 8 BTA 914 (1927)
- Exacto Spring Corp. v. Commissioner, 196 F.3d 833 (7th Cir. 1999)
- Menard, Inc., v. C.I.R., 560 F.3d 620, 623 (7th Cir. 2009)
- Brewster v. C.I.R., 607 F.2d 1369 (D.C.Dir. 1979)

PRIOR YEARS SERVICES

Per Legal, compensation for prior years may be taken in current years when it can be shown that a PSI/RC allowance was not taken because the partnership was in a loss state in the previous year and was unable to do so for the partner(s) providing the service(s).

REASONABLE CAUSE

[redacted]

Note: This subtraction modification does not flow through to the partners on Schedule K-1-P and is not subject to a subtraction modification even for those partners that are partnerships, nor is it included in the computation of income on a composite return (IL-1023-C) under 86 IAC § 100.5130(a)(2)(A).

(v) Share of Income Distributable to Partner Subject to Replacement Tax

(IITA § 203(d)(2)(I))

This modification on the IL-1065 is labeled as "Share of income distributable to a partner subject to replacement tax". Since the pass-through entity is subject to replacement tax on its share of flow-through income from the partnership, there would be a double taxation if the partnership also paid replacement tax on the same base income.

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This modification originally appeared as:

> An amount equal to all amounts of income distributable to an entity subject to the Personal Property Tax Replacement Income Tax imposed by subsections (c) and (d) of Section 201 of this Act.

Public Act 85-731, effective for taxable years ending on or after December 31, 1987, amended this Section of the IITA to add the provision "...including amounts distributable to organizations exempt from federal income tax by reason of Section 501(a) of the Internal Revenue Code."

IRC § 501(a) is the statute that exempts organizations listed in IRC § 401(a) and §501(c) from tax. IRC § 401(a) deals with qualified pension plans. IRC § 501(c)(3) exempts churches, charitable organizations and educational organizations. Income distributed to these types of partners should be allowed as a subtraction on the IL-1065, Part 5, Line 27 (for tax years 2006 and later.)

For purposes of this subtraction modification, an investment partnership that meets the requirements under IRC § 761 and elects out of the partnership provisions is NOT an entity subject to replacement tax because no federal or state return is required.

The effect of the modification is to ensure that if a partner in a partnership is subject to Replacement Tax on its distributive share of the partnership's income, this distributive share is not also included in the partnership's base income, thereby creating a double taxation on the same income. Conversely, if the partner has a loss from the partnership, the amount of the loss used to offset the Replacement Tax liability of the partner, is added back to the partnership's unmodified base income. The effect of PA 85-731 was to clarify that the partnership may also take this subtraction modification for amounts distributed to partners who are exempt from federal income tax. The amounts distributed to these types of partners were always eligible for the subtraction modification. REF: Sunshine Letter IT87-0043.

The amount reported comes from Schedule B.

For tax years ending on and after December 31, 2014, use Column E total. Each partner’s share is calculated using the Column E Worksheet included with the Schedule B Instructions.

For tax year ending on or after December 31, 2007 and before December 31, 2014, use Column D total. Each partner’s share is calculated using the Column D Worksheet included with the Schedule B Instructions.

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If the partnership has income as reported on the Schedule B, the income amount is reported as a subtraction. If the partnership has a loss instead of income, then an addition modification will be reported for "The amount of loss distributable to a partner subject to replacement tax".

The addition modification for "the amount of loss distributable to a partner subject to replacement tax" and the subtraction modification "income distributed to a partner subject to replacement tax" DOES NOT pass through to shareholders on Schedule K-1-P, nor are they included in the computation of income on a composite return (IL-1023-C) under 86 IAC § 100.5130(a)(2)(A).

For Tax Years Prior to 12/31/2007

In order to determine the amount of the modification, the following worksheet should be completed. For all partners subject to Replacement Tax (or exempt from federal taxation by reason of IRC § 501(a)), enter their share(s) of distributable income. Multiply each line reference in the worksheet by the percentage of total ownership in the partnership attributable to these partners.

1.	Enter the partner's share(s) of their distributable income included in Line 13	_____		
2.	Enter the partner's share(s) of State, Municipal and Other interest income include in Line 15	_____		
3.	Enter the partner's share(s) of "other additions" Line 22	_____		
4.	Add Lines 1, 2 and 3		_____	
5.	Enter the partner's share(s) of interest income from U.S. Treasury Obligations from Line 24	_____		
6.	Enter the partner's share(s) of "other subtractions" Line 33	_____		
7.	Add Lines 5 and 6		_____	
8.	Subtract Line 7 from 4			
	If result is positive, enter it as a subtraction modification			_____
	If the result is negative, enter it as an addition modification			_____

Form IL-2569, Personal Property Replacement Tax (Partner's Annual Certification), must be filed with the IL-1065 to support the subtraction

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modification. This is a one page form which lists the partnership and the name, address and FEIN of the partner paying the replacement tax.

If the taxpayer failed to give their partners a Schedule K-1-P and we have evidence that certain partners were subject to replacement tax but did not file an Illinois return, including foreign entities, we cannot amend form IL-2569 to exclude income distributed to those partners. Under IITA § 203(d)(2)(I) it states: "An amount equal to all amounts of income distributable to an entity subject to the [replacement tax] ..." Because of the way this subtraction modification is worded no proof is required that they filed an Illinois return. We would have to allow the subtraction modification and then audit the partners, including any foreign entity that should have filed. The auditor is responsible for bringing any nonfilers into compliance, even if the partner is out-of-state. The audit supervisor can request assistance from BIT Discovery or from other audit supervisors to close the audits on the partners.

If trusts and estates are listed on form IL-2569 the auditor should verify if the trust is subject to tax on the IL-1041 because grantor trusts do not file IL-1041s. Also, estates are not subject to replacement tax even though they file an IL-1041. Income distributed to an IRA account is considered income distributed to a trust because the IRA is subject to tax on any unrelated business taxable income.

Note: Information previously reported on the IL-2569 is included on Schedule B for tax years ending on or after December 31, 2007.

For Tax Years Prior to 1988

If this modification results in a negative amount, it is added back on the "other additions" modification line and explained. If, however, the modification results in a positive amount, it is added to the "amount equal to the share of income distributable to a partner subject to Illinois replacement tax" amount.

(vi) Expenses to Carry Tax-Exempt Interest Subtraction

(IITA § 203(d)(2)(J))

For a detailed discussion of this modification, refer to Chapter 25.

(vii) Enterprise / River Edge Redevelopment Zone Dividends

(IITA § 203(d)(2)(K))
(86 IAC §100.2480)

For a detailed discussion of this modification, refer to Chapter 25.

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The Enterprise Zone Dividend Subtraction was eliminated for tax years ending on or after December 31, 2013.

The subtraction is reported in Step 5 of the IL-1065 and calculated on an IL Schedule 1299-A.

If the partnership is a partner in another partnership, shareholder in an S corporation or a beneficiary in a trust, the amount of the deduction the partnership may claim will be reflected on a K-1-P or K-1-T.

(viii) Job Training Project Contributions

(IITA § 203(d)(2)(L))

For a detailed discussion of this modification, refer to Chapter 25.

The subtraction modification is reported on Schedule M, Line 26 for tax year 2017 and Line 25 for tax years 2016-2011. (For tax years 2010 and prior the line numbers vary.)

(ix) Foreign Trade Zone (Sub-Zone)/High Impact Business Dividends

(IITA § 203(d)(2)(M))

For a detailed discussion of this modification, refer to Chapter 25.

The subtraction is reported in Step 5 of the IL-1065 and calculated on an IL Schedule 1299-A.

If the partnership is a partner in another partnership, shareholder in an S corporation or a beneficiary in a trust, the amount of the deduction the partnership may claim will be reflected on a K-1-P or K-1-T.

(x) Claim of Right Subtraction

(IITA § 203(d)(2)(N))

For a detailed discussion of this modification, refer to Chapter 25.

This subtraction is reported in Step 3 of Schedule M.

(xi) Federal Bonus Depreciation

(IITA § 203(d)(2)(O))

For a detailed discussion of this modification, refer to Chapter 25.

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The amount of the subtraction is calculated on the IL-4562 and reported in Step 5 of the IL-1065.

(xii) Bonus Depreciation – Reversal of Subtraction on Disposition or End of Depreciable Life

(IITA § 203(d)(2)(P)

Refer to Chapter 25 for details regarding this subtraction modification.

The amount of the subtraction is calculated on the IL-4562 and reported in Step 5 of the IL-1065.

(xiii) Related Party 80/20 and Noncombination Rule

(IITA § 203(d)(2)(Q, R, S & T))

For a detailed discussion of this modification, refer to Chapter 25.

The amount of the subtraction is calculated on the Schedule 80/20 and reported in Step 5 of the IL-1065.

For tax years ending on or after December 31, 2017, the non-combination rule is eliminated.

(xiv) Subtraction Modification "Flow-Through"

If the partnership is a partner in another partnership, a shareholder in an S corporation or a beneficiary of a trust or estate, the partnership's distributive share of any subtractions from any of these entities is subtracted in the computation of base income. Each of the entities must provide the partnership information showing what subtraction modifications have "flowed through" to that partner, shareholder, etc. Be sure that these amounts have been included in the partnership's unmodified base income and that they are allowable subtractions to the partner.

If the entities distributing the income file Illinois income tax returns, this amount can be verified on Schedule B of the IL-1065 or IL-1120ST; or Schedule D of the IL-1041 as the partnership's share of subtraction modifications.

This subtraction modification is reported on the IL-1065, Step 5, Line 32.

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(xv) Lloyd's Plan of Operation Income

(IITA § 502(f))

Subtract any income that was included in your adjusted gross income from a Lloyds plan of operation and reported on Form IL 1023-C (for tax years ending prior to December 31, 2014) or IL-1065 (for tax years ending on or after December 31, 2014).

Income tax on a Lloyd's Plan of Operation income is taxed separately from the taxpayer's other income and paid on the taxpayer's behalf by Lloyd's. Therefore, if Lloyd's income is included in the taxpayer's FTI, it must be subtracted out.

This subtraction modification is reported on Schedule M.

(xvi) Retirement Income

The partnership could receive federal 1099-R distributions for social security income and retirement income; however, this income is not subject to a subtraction modification on the IL-1065. Under IITA § 203(d)(2) the computation of base income for a partnership starts with the partnership's federal taxable income (as defined in IITA § 203(e)(2)(H)), which is then modified by the statutorily prescribed addition and subtraction items. Regarding the modification items, IITA § 203(h) states that unless expressly provided there shall be no modifications to federal taxable income when computing Illinois base income.

IITA § 203(d)(2) does not contain a subtraction modification for retirement income. Although IITA § 203(a)(2)(F) does allow individuals a subtraction modification for certain types of retirement income, no such modification applies to the IL-1065.

The flow-through income to the individual could be exempt. IITA § 203(a)(2)(F) provides the following subtraction modification:

> An amount equal to all amounts included in such total pursuant to the provisions of Sections 402(a), 402(c), 403(a), 403(b), 406(a), 407(a) and 408 of the Internal Revenue Code, or included in such total as distributions under the provisions of any retirement or disability plan for employees of any governmental agency or unit, or retirement payments to retired partners, which payments are excluded in computing net earnings from self-employment by Section 1402 of the Internal Revenue Code and regulations adopted pursuant thereto.

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The subtraction modification allowed to individuals is limited to distributions from qualified retirement plans under federal law, government plans, and certain payments to retired partners. The information provided does not allow for a determination that the annuity income in this case qualifies for the subtraction modification under IITA § 203(a)(2)(F). See Publication 120 on Retirement Income for more information.

(4) Illinois Base Income

Illinois base income is computed in Step 6 of the IL-1065. Step 6 of the IL-1065 is the same as Step 4 of the IL-1120. Like the corporate return, this section is only completed if the partnership earned income from sources both within and without Illinois. Base income of partnerships, including limited partnerships, is apportioned and allocated among Illinois and other jurisdictions in the same manner as it is allocated or apportioned for any other nonresident. REF: IITA § 305(c).

Note: For taxable years ending on or after December 31, 2004 partnerships that meet the definition of an investment partnership under IITA § 1501(a)(11.5) and 86 IAC §100.9730 are not subject to tax under IITA § 305(c-5) and its income is distributable as nonbusiness income allocated to the partner's state of residence (if an individual) or state of commercial domicile for any other entity.

In order to compute the Illinois base income of a partnership, total base income must first be classified as either business or nonbusiness income. Nonbusiness income is eliminated in Step 6. Business income received from other partnerships, trusts and estates is then eliminated on Line 37 to arrive at apportionable business income.

Business income of a partnership is apportioned under IITA §304 and 86 IAC §§ 100.3500 and 100.3380(d).

For an in-depth discussion of auditing the apportionment formula, refer to Chapter 27.

Nonbusiness income (loss) allocable to Illinois is added back in Step 6, Line 44.

Business income received from other partnerships, trusts and estates, which is apportionable to Illinois, is added back in Step 6, Line 45 in order to arrive at base income or loss allocable to Illinois.

The following paragraphs discuss several of the above income items in detail.

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(a) Nonbusiness Income

Nonbusiness income of a partnership or S corporation is determined in the same manner as that of a "C" corporation for Illinois income tax purposes.

For an in-depth discussion of business v. nonbusiness income, refer to Chapter 26.

Generally speaking, the ordinary income of a partnership or S corporation, by its very nature, will be business income to the partnership or S corporation. However, be sure to verify this. Any other income may or may not be business income. IN MAKING THIS DETERMINATION, IT DOES NOT MATTER HOW THE INCOME IS CHARACTERIZED ON THE FEDERAL FORM 1065 or 1120S RETURN. A business/nonbusiness determination is made based upon 86 IAC § 100.3010. Allocation of nonbusiness income is under IITA § 303 and 86 IAC § 100.3220.

If the partnership is an Illinois filer, then the determination of whether or not income is business or nonbusiness income is made by the partnership and not the partner. Business activities of the partner are irrelevant. Ref: 86 IAC § 100.3500(b)(1).

For taxable years beginning on or after January 1, 2003, an Illinois partnership that files an IL-1065 can elect to treat all income as business income under 86 IAC § 100.3015 by checking a box on the original return filed by the due date (including extensions). If a partnership, estate, trust or S corporation makes this election, any such election is binding on the partners, beneficiaries and shareholders under 86 IAC § 100.3015(c). If the partnership, S corporation, trust or estate does not make the election to treat all income as business income, then it must apply the rules in 86 IAC § 100.3010 to determine whether the income is business or nonbusiness.

Nonbusiness income is allocated by the partners as though it were paid directly to the partners in their separate capacities (86 IAC § 100.3500(c)). If the partnership has no nexus and does not file an IL-1065, then there is no election and the partner or shareholder must determine what income, if any, is nonbusiness under 86 IAC § 100.3010.

When determining nonbusiness income, do not include any income that was subtracted in Step 3 of the IL-1065. This income is no longer in base income and, therefore, would not be a part of the business/nonbusiness income classification.

A partnership may also have nonbusiness income from partnerships in which it was a partner, or from trusts or estates of which it was a beneficiary. In

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order for this income to be classified as nonbusiness income, it must have been so classified by the entity which generated the income. If the partnership is claiming any nonbusiness income from partnerships, trusts, and/or estates, this amount should be verified by obtaining a copy of the Illinois income tax return of the pass-through entity which generated the income. Partnerships will show the flow-through amount on Schedule B of the IL-1065 and Schedule K-1-P, and trusts and estates show this amount on Schedule D and Schedule K-1-T. If a partnership receives nonbusiness income from another partnership, trust or estate, then that income is allocated by the receiving partnership as if each item of income had been paid, incurred, or accrued directly to that partnership in its separate capacity. REF: IITA § 305(b).

Example 1: Partnership A is currently under audit. In the course of the audit, it is determined that Partnership A is a partner in Partnership F and Partnership G. Both Partnership F and Partnership G file IL-1065 returns and have individual partners. Partnership F reports $100,000 in business income and Partnership G reports $50,000 in business income and $20,000 in nonbusiness income on their respective IL-1065's.

Partnership A has a 50% interest in each partnership. Partnership A will report partnership business income of $75,000 and will determine whether or not the $10,000 of nonbusiness income is taxable in Illinois based upon the nonbusiness income rules in 86 IAC § 100.3220, applied as if it had received that income directly rather than through Partnership G.

Example 2: ABC Partnership, which conducts business in Illinois and Wisconsin, has an Illinois apportionment factor of 40%. In 2007, ABC Partnership earned nonbusiness interest income from the investment of funds (in the amount of $25,000) which it allocated to Wisconsin on its IL-1065. Partnership X, which is commercially domiciled in Illinois, has a 50% interest in ABC partnership. Therefore, $12,500 in nonbusiness interest income from ABC Partnership will pass through to Partnership X.

This interest income will be treated as nonbusiness income allocable to Illinois because Partnership X is commercially domiciled in Illinois. Ref: 86 IAC §§ 100.3220(f) and 100.3300(b)(2). The income will be subtracted on Partnership X's IL-1065 as nonbusiness income on Step 6, Line 36 and added back as nonbusiness income allocable to Illinois on Step 6, Line 44 (based on 2013 line references).

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Note: In both examples in which nonbusiness income was claimed and allowed, the taxpayer could have business expenses subject to recapture under 86 IAC § 100.2405(d).

In certain instances, Step 6 of the IL-1065 may not be completed. It is very common for a partnership to have zero base income. The partnership normally accomplishes this by subtracting all of its unmodified base income through either the subtraction modification for personal service income or for partners subject to replacement tax. In this situation, a partnership may or may not file an IL-1065. A partnership is not required to file an income tax return if it does not have sufficient business activity in Illinois to establish nexus in this State or if it has no income allocable to Illinois. However, the partnership may be required to withhold tax from income flowing through to nonresident partners and, for tax years ending on or after December 31, 2014, will be required to file an IL-1065 to report the withholding.

If the partnership from which the partner is receiving income does not file an IL-1065, or does not complete Step 6, it may be necessary to audit the partnership. This may have to be done in order to determine if any of the income should be considered nonbusiness income of the partnership and to establish the proper apportionment formula for the amount of income which is determined to be business income of the partnership.

As a practical matter, if the partnership (from which the partner receives income) is not commercially domiciled in Illinois, it is doubtful whether any income of the partnership would be taxable to the partner in Illinois, unless the partner and the partnership are unitary. If the partnership earned any income from tangible sources which is allocable to Illinois, they should be filing a return. (Be alert for any information which may indicate that the partnership SHOULD be filing Illinois returns.) Any intangible income earned by the partnership which is passed through to the partner would normally only be taxable to the partner if the partner was commercially domiciled in Illinois. With the above information in mind, take a look at all of the Schedule K-1's of the partnership which is being audited to see if there is any tax potential in Illinois. If so, this should be pursued. When allowing nonbusiness income be sure it is net of any deductions which are allocable to it and make sure that there are no business expenses subject to recapture under 86 IAC § 100.2405(d).

(b) Partnership Business Income

A partnership may be a partner in several partnerships. The business income (loss) from each of these partnerships should be eliminated on the IL-1065, Step 6, but only if the partnership is not unitary with the partners. If they are unitary, then the flow-through partnership income is included in base income

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and there is no income or loss elimination. Business income or loss from each of the partnerships is then separately apportioned based on that partnership's Illinois apportionment factor. If the partnership had no activity in Illinois, the income would simply be eliminated as non-unitary partnership income or loss. However, if the partnership had any income which was earned in Illinois, the income the partner receives from that partnership must be separately apportioned based on that partnership's formula. The partner's share of the Illinois partnership business income is then added back on Step 6, Line 45 of the IL-1065.

Example: Partnership K is a partner in XYZ Partnership and ABC Partnership. Both XYZ Partnership and ABC Partnership have business activity within and without Illinois and, therefore, file IL-1065's. XYZ Partnership has an Illinois apportionment formula of 60% and ABC Partnership has an Illinois apportionment formula of 25%. Partnership K receives business income from XYZ Partnership in the amount of $150,000. Partnership K also receives a partnership business loss from ABC Partnership in the amount of ($10,000).

If Partnership K is not unitary with XYZ Partnership or ABC Partnership, then Partnership K will subtract $140,000 on Step 6, Line 37 of its IL-1065. Partnership K will then add back $87,500 as partnership business income allocable to Illinois (on Step 6, Line 45) which is computed as follows:

($150,000 x .6) - ($10,000 x .25) = $87,500

IITA § 305(a) and 86 IAC § 100.3500(b) require that business income of a partnership flow through to the nonresident partners as business income to those partners. This flow through is reported to the partner on Schedule K-1-P, Step 4, Column A, which is based on each partner's distributive share of the partnership's income for the taxable year. The partner's percentage can be found on Schedule B (for tax years 2006 and prior) of the distributing partnership's IL-1065. In order to determine the partner's share which is allocable to Illinois, obtain a copy of the IL-1065 for that partnership. In some cases, several partnerships may be conducting business in Illinois. If so, copies of the IL-1065's for all of the partnerships should be obtained, the total allocable to Illinois from each partnership should be added together and included on Step 6 for non-unitary partnership business income or loss apportionable to Illinois. If the flow-through income is from unitary partnerships, those unitary partnerships' income will be included in base income subject to apportionment, and the flow-through sales numerator and

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denominator will be included in with the partnership's own sales numerator and denominator. (86 IAC § 100.3380(d)(2)(A))

Partnership income received by a partnership can be included in any type of income (loss) on the Schedule K-1.

A partnership may be a beneficiary of an estate or trust (fiduciary). Business income (loss) from trusts and estates is allocated per IITA § 307(a). This income must be subtracted from base income in order to arrive at apportionable business income of the partnership. The amounts come from Schedule K-1-T, Step 4 supplied by the fiduciary and are carried to the partnership's IL-1065, Step 6. The fiduciary should have supplied the partnership with Schedule K-1-T(2) Beneficiary's Instructions.
IITA § 307(a) requires that the business income of an estate or trust flow through to a nonresident beneficiary as business income. This is computed by multiplying the beneficiary's distributive share of the fiduciary's income by the fiduciary's apportionment formula and is reported to the beneficiary on Schedule K-1-T, Step 4, Column B.

(c) Illinois Net Loss / Deduction

The Illinois net loss from a partnership or subchapter S corporation does not flow through to partners or shareholders and therefore is not reported to the partner or shareholder on Schedule K-1-P. Illinois net losses of a partnership can only be used by the partnership. Ref: 86 IAC § 100.2330(f)(4)(C).

The amount reported as an Illinois net loss deduction is calculated on the Schedule NLD.

For more detailed information regarding INOL Carryforward/Carryback provisions, refer to Chapter 35.

(d) Credits

(i) Form IL-477 Replacement Tax Investment Credit (RTIC)

Replacement Tax Investment Credits are calculated on Form IL-477 (IL-1120, IL-1065, IL-1120-ST, IL-1041, IL-990-T or IL-1023-C (for tax years 2010 and forward)).

(a) For Tax Years Ending on or After December 31, 2000

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The RTIC will automatically flow through to partners and S corporation shareholders subject to replacement tax. The amount allocable to partners and shareholders not subject to replacement tax will remain with the partnership or S corporation. (Ref: 86 IAC § 100.2101(h)(2))

The new automatic pass through applies only to the RTIC earned during the taxable year and does not apply to carry forwards. (Ref: 86 IAC § 100.2101(h)(2)(B).

(b) For Tax Years Ending Before December 31, 2000

IITA § 201(e) allows partnerships an election to pass the RTIC that they are entitled to through to their partners. This change was considered effective on August 17, 1997 when the change became law. However, this position was challenged in Borden Chemicals & Plastics, L.P. v. Zehnder, 312 Ill. App. 3d 35 (2000). The court ruled in favor of the taxpayer and required the Department to apply the pass-through election retroactively. Therefore, because of this decision, the Department has decided to adopt the policy to allow all partnerships to elect to pass through RTIC to their partners for all years that the statutory period is open. If they make this election, all of the credit must be passed through to the partners even if they are not subject to replacement tax. The amount of RTIC that the partnership is entitled to include is the credit earned in the taxable year and any allowable RTIC carried forward.

The RTIC can only be carried forward five years from the year that it is earned. Therefore, the auditor must verify when the entity earned the RTIC and how many years it carried the credit forward before passing it through to the partners.

Recapture of the investment credit is required if the property ceases to qualify. The amount to be recaptured is calculated on Form IL-4255.

For more detailed information regarding the RTIC, refer to Chapter 36.

(ii) Schedule 1299-A

Subtraction modifications and credits for partnerships and S corporations are calculated on Schedule 1299-A Tax Subtractions and Credits (for IL-1065 and IL-1120-ST filers only).

Below is a list of subtraction modifications and credits (as of 2017) on Schedule 1299-A for partnerships and S corporations, along with the applicable regulation.

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(a) Subtraction Modifications, Step 1

- Dividends from River Edge Redevelopment Zones (86 IAC § 100.2480)
- Dividends from High Impact Business within a Foreign Trade Zones (or sub-zones) (86 IAC §100.2490)
- Contribution to a zone organization (Form IL-1120-ST filers only) (IITA § 203(b)(2)(N)).
- Interest income from a loan secured by River Edge Redevelopment Zone, or High Impact business property (Form IL-1120-ST financial organizations only) (86 IAC § 100.2655)

(Enterprise Zone Subtractions were removed from the Schedule 1299-A beginning in tax year 2013.)

(b) Credits, Step 2

- Film Production Services Tax Credit (86 IAC § 100.2185)
- Enterprise Zone or River Edge Redevelopment Zone Investment Credit (River Edge Redevelopment Zone Investment Credit expired for tax years beginning on or after July 12, 2016) (86 IAC § 100.2110)
- Tax Credit for Affordable Housing Donations (86 IAC § 100.2190)
- Economic Development for a Growing Economy (EDGE) Credit (86 IAC § 100.2198)
- Research and Development Credit (originally expired for tax years ending after December 31, 2015) (86 IAC § 100.2160) P.A. 100-0022 retroactively restored the credit for tax years ending after December 31, 2015. A supplemental Schedule 1299-A (R&D) has been designed to allow the credit to be claimed for the 2016 tax year.
- Ex-Felons Jobs Credit (IITA § 216)

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- Veterans Jobs Credit (expired for tax years ending after December 31, 2016) (IITA § 217)

- Student-Assistance Contribution Credit (IITA § 218)

- Angel Investment Credit (originally expired for tax years ending after December 31, 2016) (IITA § 220)(86 IAC § 100.2171) P.A. 100-0328 has retroactively restored this credit for tax years ending after December 31, 2016.

- New Markets Credit

- River Edge Historic Preservation Credit (IITA § 221)

- Live Theater Production Tax Credit (IITA § 222)

- Hospital Credit (IITA § 223)

- Historic Preservation Credit (expired for tax years ending after December 31, 2015) (IITA § 219)

All income credits on 1299-A are distributable by partnerships and S corporations and require Schedule K-1-P to support distributive share amounts. Pass-through amounts applicable to each partner/shareholder are reported in Step 5 (subtractions) and Step 7 (credits) on Schedule K-1-P.

If the partnership/S corporation is a partner in a partnership or a shareholder in an S corporation, any deductions or credits reported on Schedule K-1-P are to be claimed on Schedule 1299-A.

Refer to Chapter 36 for more details regarding credits.

g) Schedule B Partners' or Shareholders' Identification

The Schedule B is used to:

- Identify any person (***both resident and nonresident***) who was a partner or shareholder at any time during the tax year.
- Identify partners or shareholders subject to Illinois Personal Property Tax Replacement Income tax.
- Figure the share of distributable income or loss that is to be added or subtracted from partnership's/S corporation's base income.

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For these reasons, it is important to verify that Schedule B is completed correctly.

For Tax Years Ending on or After December 31, 2014

The Illinois Schedule B was redesigned to report certain items of income and credits reported to partners or shareholders, and pass-through withholding payments made on behalf of ***nonresident*** partners or shareholders. Amounts that would have been reported on behalf of a partnership's or S corporation's members on Form IL-1023-C and Form IL-1000 must now be reported on the Illinois Schedule B since those forms were eliminated for tax years ending on and after December 31, 2014.

Schedule K-1-P, Schedule K-1-P(3) (or Schedule K-1-P(3)-FY), as applicable and all of Schedule B, Step 2 must be completed before completing Schedule B, Step 1.

Note: Schedule(s) K-1-P(3) and K-1-P(3)-FY are new forms for tax years ending on and after December 31, 2014 and are explained in the Pass-through Withholding Calculation section.

The completed Schedule B is used to support amounts reported on the following:

Schedule B	IL-1065	IL-1120-ST
Step 1, Line 8	Step 8, Line 59	Step 8, Line 58
Step 1, Line 3 (if a negative)	Step 4, Line 21	Step 4, Line 20
Step 1, Line 3 (if a positive)	Step 5, Line 27	Step 5, Line 24

For Tax Years Ending prior to December 31, 2014

Starting with tax years ending on December 31, 1998 Schedule B, Partners' or Shareholders' Identification, is included with Form IL-1065 and IL-1120-ST. Schedule B is the required schedule for listing the entity's partners' and shareholders' information, and must be provided to the Department if any income is passed to a partner or shareholder.

For tax year ending December 31, 2009 the amount shown on Schedule B, Step 2, Line 7 will be reported as follows:

Schedule B	IL-1065	IL-1120-St
Step 2, Line 7 (if a negative)	Step 4, Line 21	Step 4, Line 20
Step 2, Line 7 (if a positive)	Step 5, Line 27	Step 5, Line 24

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For tax years ending on or after December 31, 2007 and on or before December 31, 2008 the amount shown on Schedule B, Step 2, Line 8 will be reported as follows:

Schedule B	IL-1065	IL-1120-ST
Step 2, Line 8 (if a negative)	Step 4, Line 21	Step 4, Line 20
Step 2, Line 8 (if a positive)	Step 5, Line 27	Step 5, Line 24

Prior to 1998 the Schedules B and C were included with the Form IL-1120-ST, before being replaced with Schedule B in 1998.

Effective January 1, 1993 through 1997 partnerships were not required to submit Schedules B and C along with their IL-1065 due to an amendment to Section 502(d) of the IITA; however, the partnership was to retain this information and to furnish it to the Department upon request.

Prior to 1993 the partnership attached to its IL-1065, Schedules B and C which listed each partner by name, SSN or FEIN, and each partners' share of pass-through addition and subtraction modifications, tax credits and recapture amounts.

h) Schedule K-1-P

Schedule K-1-P was created so that the partnership/S corporation could report to each individual or entity who was a partner/shareholder with its share of business and nonbusiness income, flow-through modifications, credits, recapture, and pass-through entity payments. Prior to 1998 the Department had no designated form for the partnership to send to the partner to indicate the pass-through amounts thereby requiring that the partnership create its own form or schedule to send to their partners.

Partners and shareholders that receive Schedules K-1-P are instructed to attach them to their Illinois returns. The partnerships and S corporations that issue the K-1-Ps are not to attach them to their own respective Form IL-1065 or IL-1120-ST; however, they are to retain copies of each issued K-1-P available for Department inspection upon request.

Schedule K-1-P(1) contains the instructions used by the partnership or S-corporation to complete the Schedule K-1-P. In addition, the taxpayer must send each partner or shareholder Schedule K-1-P(2) Partner's and Shareholder's Instructions. Refer to those instructions for more information.

The Schedule K-1-P was prescribed by the Department to provide notification to partners/shareholders of any Illinois income that is allocated to them from a

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partnership/S corporation. The schedule is for the convenience of the partner/shareholder. The Department has not taken the position that the schedule is necessary for full compliance. This means that the taxpayers are not required to utilize the K-1-P that is issued to them when they file their Illinois returns. If taxpayers receive what they believe to be an incorrect Schedule K-1-P, a corrected K-1-P should be obtained.

Not all of the addition and subtraction modifications flow through to the partner/shareholder. The Schedule K-1-P lists all of the flow-through modifications and credits.

If the taxpayer has reported any other pass-through addition modifications, refer to the instructions on the Schedule K-1-P(1) or Schedule M.

Although the partnership/S corporation is required to report the addition and subtraction modifications to its partners/shareholders, not all partners/shareholders can claim the deduction on their respective Illinois returns.

Schedule K-1-P, Step 3, Column B for Illinois nonbusiness income

Step 3 lists the following items of nonbusiness income:

- Interest, dividends, and gain (loss) on the sale of intangible personal property:

  Interest and dividend income is allocated to the state of residency if an individual, trust or estate, or to the state of commercial domicile if a corporation. Ref: 86 IAC § 100.3300(b)(2). Gain on the sale of intangibles is allocated to the state of commercial domicile if received by a corporation. Ref: 86 IAC § 100.3220(b)(3). For an individual, trust or estate Column B is zero if the partner/shareholder has an out-of-state address. If the partner/shareholder is a corporation with an Illinois address, then the instructions to the Schedule K-1-P say to copy the Column A amount into Column B. The amount in Column A should coincide with the partner's percentage share on the federal Schedule K-1.

- Rental Income, royalty income, gain or loss on the sale of tangible personal property or real property:

This income is generally allocated to the state where the property is located that generated the income. Ref: 86 IAC §§ 100.3220(c) & (d). If there is a gain on the sale of tangible personal property, then the income is allocated to the situs of the property, or to the commercial domicile if the taxpayer is not taxable in the state of situs. Ref: 86 IAC § 100.3320(b)(2). Therefore, the instructions to the Schedule K-1-P say that the Step 3, Column B amount representing Illinois

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nonbusiness income should be the shareholder's share of the Schedule NB, Column B amount.

Schedule K-1-P, Step 4, Column B for Illinois business income

Step 4, Column A represents the member's share of the U.S. Schedule K-1, less any nonbusiness income reported in Step 3. The Column B amount representing Illinois business income is the Column A amounts multiplied by the Partnership's/Subchapter S corporation's Illinois apportionment percentage or, in the case of income flowed up from another partnership or a trust or estate, to the extent apportioned to Illinois by the entity that flowed the income through to the partnership.

i) Nonresident Partners

Partners, other than residents, are required to allocate to Illinois their distributive share of the business income of the partnership which is allocated or apportioned to Illinois by the partnership. Partners allocate to Illinois their distributive shares of the partnership's nonbusiness income as if such income had been paid, incurred or accrued directly to the partners in their separate capacities. That is, with respect to nonbusiness income, a partner follows IITA § 303 to determine whether an item of nonbusiness income should be allocated to Illinois. REF: IITA § 305(b) and 86 IAC § 100.3500(c).

IITA § 305(a) separately apportions distributive shares of partnership business income received by nonresidents based on the partnership's apportionment percentage in Illinois. However, if there is a unitary relationship between a corporate partner and the partnership, 86 IAC § 100.3380(d) will apply. This regulation provides that a partner's distributive share of partnership income is apportioned with the partner's other business income if there is a unitary relationship.

A nonresident partner's share of the partnership's taxable income apportionable and allocable to Illinois is computed on Schedule B and reported to the partner on Schedule K-1-P.

Under 86 IAC § 100.3500(b)(1) it is the partnership that makes the decision which income is business or nonbusiness income based on the partnership's activities. That is, the business income determination is based on the facts at the entity-level that earned the income, not at the subsequent flow-through levels (partners, shareholders, etc). Income that is nonbusiness is reported to the partner on Schedule K-1-P, Step 3, Column A. Column B is to report the partner's share of Illinois nonbusiness income. For partners that are individuals with an Illinois address on the last day of the taxable year, Column B is left blank because an Illinois resident reports all of his income to Illinois, but then attaches

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Schedule CR to his IL-1040 to claim credit for taxes paid to other states (86 IAC § 100.2197). Column B of Step 3 of the K-1-P is only for nonresident individuals and for all partners that are partnerships, corporations and S corporations.

For partners of investment partnerships, only Column A is completed, attaching the Schedule K-1-P(2), to allow the partner to make its own determination.

Note: Non-resident owners of partnerships, subchapter S corporations and trusts are now subject to withholding on their distributions (86 IAC § 100.7035). Refer to Pass-through Entity Withholding section.

j) Auditor's Report

The Auditor's Report for the IL-1065 is Form EDA-92. Schedule B information should be included as an audit schedule.

Any changes to the IL-1065 in audit will generally affect every nonresident partner's Illinois taxable income and may affect the resident partner's income. If so, the auditor will be responsible for making the changes to every partner's return, unless the partnership agrees to pay the tax by filing an IL-1000 or IL-1023-C, if none were originally filed, or an IL-1023-C-X or IL-1000-X amending previously filed forms (for tax years ending prior to December 31, 2014) or IL-1065 or IL-1065-X, as applicable (for tax years ending on and after December 31, 2014). Additionally, in the course of completing the IL-1065 audit, a compliance check must be done to determine if all partners are filing Illinois income tax returns. See Form IL-1000 (for tax years ending prior to December 31, 2014) or Form IL-1065 (for tax years ending on and after December 31, 2014) and 86 IAC § 100.7035 for withholding requirements.

If taxable income is increased per audit and/or it is determined there are nonresident partners who are nonfilers; these partners can be referred for audit. [redacted] Refer to Chapter 20 Audit Procedure, Referrals.

k) Exemption Due to Foreign Treaty

A partner could claim that income from an Illinois partnership is exempt due to a foreign treaty. The starting point with any Illinois return is federal taxable income. If the treaty exempts the income from federal taxation, then it would automatically apply to Illinois since federal taxable income would be zero.

Even if the income is included in federal taxable income, it could be exempt from Illinois taxation by certain treaties such as the 1951 Consular Officers Convention which covers certain employees that work in consular offices. To the extent that

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any employees in Illinois are covered by that treaty, they would claim a subtraction modification under IITA § 203(a)(2)(N).

To the extent that income is included in federal taxable income that the taxpayer claims is exempt due to a treaty, then we would have to examine that treaty. Below is a web site that the auditor can review that lists treaties with other countries:

https://www.irs.gov/businesses/international-businesses/united-states-income-tax-treaties-a-to-z

B. S Corporations

1. Federal Taxation

Under the Subchapter S Revision Act of 1982, the S corporation is treated as a conduit in which all S corporation items pass through to the shareholders while retaining any special tax characteristics. REF: IRC § 1363. The pass through to each shareholder is based on that shareholder's percentage of stock ownership on each day of the taxable year. The purpose of this Act was to give S corporation shareholders the same tax treatment as partners in a partnership.

S corporation shareholders must elect S corporation status for taxation. Currently, the additional requirements that must be met per IRC § 1361(b) are an S corporation:

- Must be a domestic corporation. That is, it must be a corporation that is either organized in the United States or organized under federal or state law.

- May not have more than 100 shareholders. A husband and wife and the estate of either one or both, are treated as one shareholder, regardless of how they own the stock. The limitation on the number of shareholders has changed over time. In 1996 the limitation was increased from 35 to 75 and in 2004 it was increased again from 75 to the current 100.

- May only have one class of stock. IRC § 1361(b)(1)(D) requires that a small business corporation have only one class of stock. This generally means that each share of stock carries identical voting rights, dividend rights, and liquidation preferences. IRC § 1361(c)(4) provides, however, that if the only difference in the shares of common stock is voting rights, that difference will not prevent the corporation from being treated as having only one class of stock.

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- Cannot have a nonresident alien as a shareholder.
- Can only have individuals, estates or certain trusts as shareholders.

Consent to be treated as an S corporation is binding and may not be withdrawn after the corporation makes a valid election. An election is effective for the entire taxable year of the corporation and for all succeeding years unless it is terminated. The election to be treated as an S corporation is made on federal Form 2553.

Subchapter S status may be terminated automatically or by revocation. Revocation is achieved by timely consent of all shareholders. Generally, once S corporation status is terminated, a new election cannot be made for five years.

Certain domestic corporations are ineligible to elect S corporation status:

- Financial institutions, which are banks as defined in IRC § 585(a)(2) or § 593.
- Insurance companies taxed under Subchapter L.
- Corporations electing application of IRC § 936 (companies electing the possession tax credit.)
- DISC'S or former DISC'S.
- Members of an affiliated group.

REF: IRC § 1361(b)(2).

a) Post – 1982 Federal Law

Federal Public Law 97-354 significantly changed the taxation of S corporations under the IRC for tax years beginning after 1982. As a result, an S corporation functions primarily as a conduit for transferring income and loss items directly to the shareholders who report such items on their own income tax returns. S corporation income received by shareholders is no longer treated as dividend income but is treated similarly to the way partnership income is treated. A federal election to "opt out" of the federal changes was allowed for casualty insurance companies and certain corporations with oil and gas production.

S corporation income is classified as separately stated and nonseparately stated income (loss). Nonseparately stated income (loss), which is also called ordinary

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income (loss), is essentially gross income less deductions, excluding the separately stated items. This is computed on page one of the 1120-S. Ordinary income of S corporations is taxable to the shareholders.

"Separately stated items" are items of income (including tax-exempt income), loss, deduction, or credit, the separate treatment of which could affect any shareholder's liability. REF: IRC § 1366(a)(1). Examples include short-term or long-term capital gains, gains or losses under IRC § 1231, charitable contributions, investment interest expense, interest on all-savers certificates, dividends qualifying for exclusion and tax-exempt income.

b) Permitted (Required) Year

The Tax Reform Act of 1986 did not change the rule under IRC § 1378 which stated that an S corporation's taxable year must be a "permitted year".

A permitted year

- is either a calendar year, or
- any other accounting year for which the corporation shows a business purpose that is satisfactory to the IRS.

Any deferral of income to S corporation shareholders is not a business purpose that permits an S corporation to use a taxable year other than a calendar year. Under the pre-86 law, a corporation that made its election to be an S corporation before October 20, 1982 was allowed to retain a taxable year that was not a permitted year if certain conditions were met. Under the Tax Reform Act of 1986, the taxable year of every S corporation must be a permitted year.

Another exception to the permitted (required) year-end is available under IRC § 444. An S corporation may elect, under this section, to have a different year-end, if certain conditions are met. Generally, IRC § 444 applies to the first taxable year beginning after December 31, 1986.

c) Short Year Returns

If a corporation changed its taxable year to comply with the Tax Reform Act of 1986 taxable year rules, such a change would result in a short taxable year. When the short year and another taxable year of the S corporation both end within one taxable year of a shareholder, the shareholder's S corporation income from both taxable years will be included in that taxable year.

S corporations that changed their taxable years to comply with the Tax Reform Act of 1986, issued separate K-1's to the shareholders for both the twelve month

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and the short year return. The S corporation should have marked the "short taxable year" box on the K-1 to distinguish clearly between the two K-1's. Federally, shareholders could elect to pro-rate the short-year income over four years or report all of the short year income in 1987. If taxpayers used the four-year prorating method, the taxpayers included on their federal return, their distributive share of income from the twelve-month return and 1/4 of the income shown on the short-year K-1. REF: 26 CFR § 18.1366-5(b).

For Illinois purposes, we are bound by the taxpayer's federal treatment of the short-year income as reflected in the taxpayer's AGI. REF: Sunshine Letter IT88-101. Additionally, under IITA § 403(a), State, Municipal and other interest income which is added back in the computation of Illinois base income may also be pro-rated over the four-year period, if this method has been elected. However, keep in mind that the four-year proration of the short-year period income takes place solely at the shareholder level.

IRC §1363(d) provides that the LIFO recapture amount is to be added to the income of a corporation electing S corporation status for its last taxable year as a C corporation. The increase in tax from this recapture amount is to be PAID in four equal installments, one-fourth due on the due date of the last C corporation return and one-fourth due on the due dates of the corporation's return for the succeeding three taxable years.

Since nothing in the IITA, nor the Regulations, permits an extension of time for PAYING the tax due, the additional Illinois tax resulting from the inclusion in gross income of the LIFO recapture amount pursuant to IRC § 1363(d) cannot be paid in four equal installments for Illinois purposes. REF: Sunshine Letter IT88-0338 & IT91-270.

Terminations resulting from revocation or from a change in the S corporation's status can become effective on a specific date other than the beginning of a taxable year. IRC § 1362(e) provides that if an S corporation status terminates on any day other than the first day of a taxable year, the regular taxable year is divided into two short years. That part of the taxable year ending before the date of termination is treated as a short year subject to provisions for an S corporation. That part of the taxable year beginning with the date of termination is treated as a short year subject to provisions for a C corporation. REF: IRC § 1362(e).

26 CFR § 1.1372-4(b)(5)(iv)(a) provides that "gross receipts" are the total amounts received or accrued by a corporation under its method of accounting used to compute taxable income. IRC § 1362(d)(3)(C) also provides, for years beginning after 1982, that the net gains from the sale of capital assets (other than stock or securities) are included in determining gross receipts.

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d) Federal Form 1120-S

Federal Form 1120-S is filed by a domestic corporation that has elected to be treated as a Small Business Corporation (S corporation) for federal income tax purposes. The election is made by filing federal Form 2553 with the IRS. The return is due on the 15th day of the third month following the close of the taxable year.

Income and expenses derived only from a trade or business activity are considered in determining the ordinary income (loss) of the S corporation. These items are reported on page one of federal Form 1120-S. The supporting schedule for Cost of Goods Sold is reflected on federal Form 1125-A for tax years 2011 and forward. (Cost of Goods Sold was reported on Schedule A (federal Form 1120-S) for tax years 2010 and prior). Various informational data about the S corporation is required to be answered on the federal return. As with partnerships, ordinary income (loss) for the S corporation is then carried to Schedule K (Shareholders' Shares of Income, Credits, Deductions, Etc.). Note that income from other rental activities and portfolio income are entered directly on Schedule K.

Note also, that, if a C corporation has assets whose fair market value exceeds their tax basis at the time it elects S corporation status, the S corporation may be taxed on this “built-in gain” when the assets are sold. Amounts on the Schedule K (including operating income) are reported net of any related built-in gains tax incurred by the S corporation, so the operating income on the Schedule K may be less than the amount reported on page 1 of the Form 1120-S.

Federal Form 8825 was developed to report income and expenses from rental real estate activities of a partnership or S corporation. It replaced the former lines 2a and 2b of Schedule K (Form 1120-S). The net income (loss) from the rental real estate activities is reflected on Schedule K.

Schedule K of the federal Form 1120-S is a summary schedule of all the shareholders' shares of the corporation's income, credits, deductions, etc. Schedule K-1 (Form 1120S) is prepared for each shareholder and shows each specific shareholder's separate share of the income, deductions, credits, etc. included in the S corporation figures on Schedule K.

The S corporation's balance sheet is reflected on Schedule L. Schedule M-1 is the Reconciliation of Income per Books with Income per Return. Tax-exempt interest on line 5a of this schedule is verification for state, municipal and other interest that is required as an addition modification on the IL-1120-ST. The Analysis of Accumulated Adjustments Account, Other Adjustments Account and

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Shareholders' Undistributed Taxable Income Previously Taxed is shown on Schedule M-2.

2. Illinois Taxation

Every S corporation (as defined in IRC § 1361(a)) which has Illinois net income or loss, or is qualified to do business in Illinois and is required to file federal Form 1120-S, is required to file an IL-1120-ST with the Department. A corporation is qualified to do business in Illinois if it is incorporated in Illinois or if it has a certificate of authority to do business in Illinois issued by the Illinois Secretary of State. REF: Sunshine Letters IT88-241 and IT88-264. An IL-1120-ST is required to be filed with the Department on or before the 15th day of the third month following the close of the taxable year.

S corporations do not have to make estimated Income Tax payments. Their resident shareholders, however, are required to include S corporation income in their estimated tax computations. As S corporations are only subject to Replacement Tax, they did not incur any tax liability in Illinois prior to July 1, 1979. Replacement Tax is assessed on S corporations at a rate of 1.5%.

Public Act 83-1352 changed the Illinois taxation of S corporation income for years ending on or after September 8, 1984 to be consistent with the federal changes made by Public Law 97-354. The effect of this change was to treat income in much the same manner as partnership income. Effective September 8, 1984, Subchapter S distributions are generally treated as apportionable (if business) or allocable (if nonbusiness) and taxable in the hands of the shareholders in accordance with IITA § 308.

Nonresident shareholders who formerly did not incur a liability under the IITA because dividends received by nonresident individuals were not allocated to Illinois, are now taxed on their share of S corporation income to the extent it is apportioned or allocated to Illinois. However, the IITA includes an "opt out" provision based on the federal "opt out" provision. REF: Sunshine Letters IT85-1049 and IT85-0616.

During the period after 1982, but before September 8, 1984, Illinois law did not reflect the federal changes; therefore, the Illinois tax liability of nonresident S corporation shareholders begins with income from S corporation tax years ending on or after September 8, 1984.

Unless a corporation has in effect a federal election to "opt out" of the provisions of the Subchapter S Revision Act of 1982 and has instead applied the prior federal Subchapter S rules as in effect on July 1, 1982, the base income of a Subchapter S corporation is apportioned pursuant to IITA § 301 through § 308. Illinois resident shareholders will have all of their S corporation income allocated

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to Illinois. The respective shares of nonresident shareholders, in business and nonbusiness income of the Subchapter S corporation, is apportioned and taken into account pro rata pursuant to IITA § 308(a) and (b).

a) Illinois Definition of a Subchapter S Corporation

86 IAC § 100.9750(c) provides the following definition of a Subchapter S corporation:

> The term "subchapter S corporation" means a corporation for which there is in effect an election under section 1362 of the Internal Revenue Code, or for which there is a federal election to opt out of the provisions of the Subchapter S Revision Act of 1982 and have applied instead the prior federal subchapter S rules as in effect on July 1, 1982. (IITA Section 1501(a)(28))
>
> > 1) Any corporation that has elected subchapter S corporation status for federal income tax purposes is automatically a subchapter S corporation for purposes of the IITA until its status as a subchapter S corporation is terminated for federal income tax purposes. No separate election is required.
> >
> > 2) Under 26 USC § 1361(b)(3), the separate existence of a "qualified subchapter S subsidiary" is disregarded and the assets, liabilities and other items of the qualified subchapter S subsidiary are attributed to the parent subchapter S corporation. Accordingly, for all purposes of the IITA, a subchapter S corporation and its qualified subchapter S subsidiaries shall be treated as a single subchapter S corporation.

b) Unitary Groups

An S corporation can be a member of a unitary group with C corporations, but they cannot be an eligible member of the combined return. (Ref: 86 IAC § 100.5201(i)). Although each Illinois nexus C corporation is a member of the combined group, an S corporation must file a separate unitary return since the IL-1120-ST has a different tax rate from C corps. A unitary group can be composed solely of S corps; however, they cannot file a combined return. Each unitary IL-1120-ST must be filed on a separate, unitary basis. The only exception would be if the Subchapter S corporations were considered QSSS's (Qualified Subchapter S Subsidiaries) for federal purposes.

The instructions on how to include a subchapter S corporation in the unitary group are in the Schedule UB Instructions. Refer to the UB Instructions for each year for specific line references.

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Steps 2 and 3 of each separately filed Form IL-1120-ST must be completed showing only the Subchapter S corporation's separate-company items. These amounts are carried to the Schedule UB.

The amounts on each member's Form IL-1120-ST addition modifications reported in Step 4 and the subtraction modifications in Step 5, not including the income or loss distributable to a shareholder subject to replacement tax, are carried to Schedule UB, Step 3, and will be included in the last column for combined totals. The Schedule UB contains the instructions for carrying the other lines.

Unitary everywhere sales, on Form IL-1120-ST, Step 6, are the unitary sales everywhere figure from Schedule UB, Step 4. Illinois sales on the IL-1120-ST include only the subchapter S corporation's Illinois sales. The IL-1120-ST, Step 6 lines for Illinois nonbusiness income/loss and non-unitary partnership income/loss include only the amounts allocated to the S corporation on the Schedule K-1-P minus the portion of those amounts allocable to shareholders subject to replacement tax.

c) Qualified Subchapter S Subsidiaries (QSSS)

For federal purposes a corporation can elect to become a Qualified Subchapter S Subsidiary (QSSS). This is a federal tax status under the IRC created by the enactment of code § 1361(b)(3)(B) in August 1996.

IRC § 1362 permits a "small business corporation" to elect taxation as a Subchapter S corporation. This term is defined in IRC § 1361(b) which provides, in part:

> (3) TREATMENT OF CERTAIN WHOLLY OWNED SUBSIDIARIES. —(A) IN GENERAL. –For purposes of this title—
>
> i. a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and
>
> ii. all assets, liabilities, items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items of the S corporation.

IITA § 1501(a)(28) provides:

The term "Subchapter S corporation" means a corporation for which there is in effect an election under Section 1362 of the Internal Revenue Code…

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Because this definition is expressly adopted by the IITA, a QSSS is not a separate corporation for Illinois income tax purposes. Instead, the QSSS is part of its parent Subchapter S, and its assets, liabilities, and items of income, deduction, and credit must be included with parent's figures in determining the Illinois income tax liabilities of the parent and its shareholders. 86 IAC § 100.9750(c).

d) Computation of Taxable Income

86 IAC § 100.2405(c)(7)(A) states:

> (A) Election in effect. For subchapter S corporations for which there is in effect an election for the taxable year under Internal Revenue Code section 1362, "taxable income" means *taxable income determined in accordance with Internal Revenue Code section 1363(b), except that taxable income shall also take into account those items that are required to be separately stated under Internal Revenue Code section 1363(b)(1).* (IITA § 203(e)(2)(G)(i))

Under the above rules the computation of taxable income on the IL-1120-ST begins with ordinary income or loss from federal Form 1120S, Schedule K, Line 1. This amount is transferred to Step 2, Line 1 of the IL-1120-ST for tax years 2006 and after (Line 1, Part 1A tax forms through 2005). Ordinary business income is then adjusted to include all other income of the S corporation and eliminate allowable expenses to arrive at unmodified base income.

86 IAC § 100.2405(c)(7)(B) lists the separately stated items under IRC § 1363(b)(1), as listed in 26 CFR §1.1366-1(a)(2):

- Gains & losses from the sales or exchanges of capital assets,
- Gains & losses from the sale or exchange of property used in a trade or business,
- Charitable contributions,
- Foreign taxes under IRC § 901,
- "Separate items involved in the determination of certain federal credits under IRC, part IV of subchapter A (section 21 35 seq.)…"
- Certain miscellaneous items listed in 86 IAC § 100.2405(c)(7)(B)(vi),
- Portfolio income or loss and related expenses as defined in 26 CFR § 1.469-0 through 11) (2007) under IRC § 469,
- Tax exempt income including state and municipal interest

These items of income (loss) and deductions are separately stated on Schedule K. Each line on the IL-1120-ST indicates which item of deduction from Schedule K is to be deducted from ordinary income. The line item for "all other

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items of income or loss that were not included in the computation of income or loss on Page 1 of federal Form 1120S" is for items from Schedule K which were not reported on page 1 of federal Form 1120S. The adjustments are made in Steps 2 and 3 because the S corporation is subject to Replacement Tax on the entire income of the corporate entity. It is important to verify in audit that the taxpayer has picked up ordinary base income from federal Form 1120-S and made the proper adjustments from Schedule K.

IRC § 965 Transition Tax

(Refer to section on Partnerships for a description of this tax)
Illinois Modification

For 2017, the IRC § 965 income is reported to the IRS on a statement separate from the federal income tax return. Due to the nature of the separate statement, this income may not be included in the federal taxable income. However, it must be included when determining Illinois Base Income. If the income was not included in the federal taxable income, an Illinois taxpayer must make the appropriate modifications.

S corporations are required to make the following modification for tax year 2017:

	IRC 965 Transition Tax Statement	Form IL-1120-ST
IRC § 965 (a)	Line 1	Step 2, Line 6
IRC § 965 (c)	Line 3	Step 3, Line 11

Attach the Statement to your return.

Any IRC Section 965 income or deduction passed through to shareholders must be identified by attaching a statement to Schedule K-1-P.

For 2018 tax years and after, the foreign earnings are included in the federal taxable income.

Note: Subchapter S corporations and partnerships may not claim the Domestic Activities Production Deduction on their IL-1120ST or IL-1065 for tax years beginning January 1, 2005, but their shareholders or partners may claim the deduction as part of their flow-through from Schedule K-1-P. See FY Bulletin 2006-07 for more information.

Penalties and the 50% meals and entertainment deduction should not be included as other expenses on IL-1120-ST, Step 3 because these expenses are not deductible under IRC § 1363(b).

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Refer to Exhibit F for an example of a 2017 IL-1120-ST line references.

(1) Modifications

Addition and subtraction modifications pertaining to 1120 (also known as "C") corporations, under IITA § 203(b) apply equally to S corporations.

Since S corporations file different federal and state returns than C corporations, the following paragraphs provide additional explanations for modifications relating specifically to S corporations.

(a) Additions

For a detailed discussion of modifications and the cite references relating to S corporations and C corporations, refer to Chapter 24.

Refer to the section on Partnerships for information regarding the Schedule M addition modification for Lloyd's Plan of Operation Losses.

(i) The amount of loss distributable to a shareholder subject to replacement tax

Refer to the corresponding subtraction modification under Partnerships.

(b) Subtractions

For a detailed discussion of modifications and the cite references relating to S corporation and C corporations, refer to Chapter 25.

Refer to the section on Partnerships for information regarding the subtraction modification for Lloyd's Plan of Operation Income.

(i) Foreign Dividend Gross-Up/Foreign Source Dividend Subtraction

(IITA § 203(b)(2)(G))
(IITA § 203(b)(2)(O))

S corporations may claim the deductions for "foreign dividend gross-up", foreign dividends and "Subpart F income" (for tax years ending on or after December 31, 1988). Since Schedule J references certain line items on the federal Form 1120, Schedule C and there is no counterpart to Schedule C for a federal Form 1120-S filer, the

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instructions to the IL-1120-ST simply say that supporting attachments must clearly identify each item taken as a subtraction.

Any deduction allowable is claimed on Schedule M, Step 3 for: "Dividends received, including IRC § 78 Foreign Dividend Gross-up and subpart F income (Form IL-1120-ST filers only).

25 Dividends received, including IRC Section 78 Foreign Dividend Gross-up and subpart F income. **(Form IL-1120-ST filers only)** **25** _____.00

(ii) Expense Deductions Disallowed Federally

(IITA § 203(b)(2)(I))

A subtraction modification is allowed for any amortizable bond premium disallowed as a federal deduction by IRC § 171(a)(2) and any expenses incurred in producing federally tax-exempt income disallowed as a federal deduction by IRC § 265(a)(1) or any interest expense disallowed as a federal deduction by IRC § 265(a)(2). These are all expenses on the S corporation's books which are not allowed on its return. These expenses will be included in Line 17 d of Schedule K which is "other items and amounts ". In order to verify this subtraction modification, a breakdown of this line should be requested. Also see 86 IAC § 100.2455(b) & (c).

(iii) River Edge Redevelopment Zone Dividends

High Impact Business Dividends
River Edge Redevelopment Zone Interest
High Impact Business Interest
(IITA § 203(b)(2)(K) &
IITA § 203(b)(2)(L)
IITA § 203(b)(2)(M)
IITA § 203(b)(2)(M-1)

The Enterprise Zone/High Impact dividend and interest subtractions are reported on Schedule 1299-A for S corporations rather than 1299-B; however, the criteria are the same.

(iv) Contribution Subtraction

(IITA § 203(b)(2)(N))

The subtraction for contributions made to designated zone organizations are reported on Schedule 1299-A for S corporations rather than 1299-B; however, the criteria are the same.

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(v) Income Distributable to a Shareholder Subject to Replacement Tax

(IITA § 203(b)(2)(S))

For taxable years ending on or after December 31, 1997, Subchapter S corporations are allowed a subtraction modification for all amounts of income allocable to a shareholder subject to the replacement tax imposed by subsections (c) and (d) of IITA § 201, including amounts allocable to organizations exempt from federal income tax by reason of IRC § 501(a).

IRC § 501(a) exempts organizations listed in IRC § 401(a) and § 501(c) from tax. IRC § 401(a) deals with qualified pension plans. IRC § 501(c)(3) exempts churches, charitable organizations, and educational organizations. Income distributed to these types of partners should be allowed as a subtraction. In particular, income distributable to an ESOP is subtractable under this provision.

Refer to corresponding subtraction modification under Partnerships.

(2) Illinois Base Income

Illinois base income is computed in Step 6 of the IL-1120-ST. Step 6 of the IL-1120-ST is the same as Step 4 of the IL-1120. Like the corporate return, this section is only completed if the S corporation earned income from sources both within and without Illinois. Base income of a Subchapter S corporation is allocated or apportioned among Illinois and other jurisdictions in the same manner as it is allocated or apportioned for any other nonresident. REF: IITA § 308(c).

Nonbusiness Income

Nonbusiness income of an S corporation is determined in the same manner as that of a “C” corporation for Illinois income tax purposes.

A business/nonbusiness determination is made based upon 86 IAC § 100.3010. Income which is determined to be nonbusiness is allocated per IITA § 303 and 86 IAC § 100.3220. Interest and dividend income received by nonresident S corporations is allocated to this State if the S corporation had its commercial domicile in this State at the time the item was paid, incurred or accrued. REF: IITA § 301(c)(2)(B).

An S corporation may also have nonbusiness income from partnerships in which it was a partner or from trusts or estates of which it was a beneficiary. In

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order for this income to be classified as nonbusiness income, it must have been so classified by the entity which generated the income. If the corporation is claiming any nonbusiness income from partnerships, trusts, and/or estates, this amount should be verified by obtaining a copy of their Illinois income tax return. Partnerships will show the flow-through amount on Schedule K-1-P and trusts and estates show this amount on Schedule K-1-T.

After all nonbusiness income is determined, it should be totaled and shown on Step 6 of the IL-1120-ST.

If any nonbusiness income is allowed, it is important to verify that the income is net of any applicable nonbusiness expenses. In addition, the auditor will have to check recapture of business expenses under 86 IAC § 100.2405(d).

For a detailed discussion of business v. nonbusiness income, refer to Chapter 26.

Non-unitary partnership business income (loss) in Step 6, is allocated per IITA § 305(a) and 86 IAC § 100.3500. Non-unitary partnership business income (loss) received by the S corporation as a partner in a partnership is subtracted from base income on Step 6, in order to arrive at apportionable business income. If the activities existing between a partnership (of which an S corporation is a partner) and an S corporation constitute a unitary business relationship, then the S corporation's distributive shares of partnership income (loss) and factors must be included in S corporation's business income and factors. REF: IIT 86 IAC § 100.3380(d).

An S corporation may be a partner in several partnerships. Every partnership is required to provide the S corporation with a Schedule K-1-P showing their distributive share of business and non-business income. All non-unitary income (loss) from each of these partnerships is to be included in Step 6. If the partnership had no activity in Illinois, this is the only adjustment that will be made; however, if a non-unitary partnership has income (loss) which was earned in Illinois, then that partnership's income must be separately apportioned. Income from each non-unitary partnership is separately apportioned based on that partnership's activities within and without Illinois.

IITA § 305(a) and 86 IAC § 100.3500(b) requires that business income of a partnership flow through to the nonresident partners as business income to those partners. This flows through to the partners on a pro rata basis, based on that partner's distributive share of the partnership's income for the taxable year. The partners' percentages can be found on Schedule B of the IL-1065. The partner’s share of partnership’s business and nonbusiness income should be on Schedule K-1-P if the partnership is an Illinois filer. In some cases, there may be several partnerships which are conducting business in Illinois. Copies

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of all of the Schedules K-1-P should be reviewed. The amount allocable to Illinois from each non-unitary partnership should be added together and included in Step 6 (non-unitary partnership business income or loss apportionable to Illinois) of the IL-1120-ST.

An S corporation may be a beneficiary of an estate or trust (fiduciary). Business income (loss) from trusts and estates is allocated per IITA § 307(a). This income must be subtracted from base income in order to arrive at apportionable business income of the corporation. This adjustment is made because the apportionment factors property, payroll, and sales which created the business income of the fiduciary were not the same as those which were used to create the income of the corporation.

Every estate or trust (fiduciary) in which the corporation is a beneficiary is required to provide the S corporation with a Schedule K-1-T showing its distributive share of income. All business income (loss) which is received from estates or trusts should be included in Step 6 of the IL-1120-ST. If the fiduciary had no activity in Illinois, this is the only adjustment that will be made. However, if the fiduciary had income (loss) which was earned in Illinois, then the fiduciary must issue each beneficiary a Schedule K-1-T indicating the amount of Illinois business income and nonbusiness income.

IITA § 307(a) requires that the business income of an estate or trust flow through to a nonresident beneficiary as business income to the beneficiary. This is computed by multiplying the beneficiary's distributive share of the fiduciary's income by the fiduciary's apportionment formula.

Business income of an S corporation is apportioned under IITA § 304. The only difference in auditing these factors and those of a C corporation, is the physical location of the items on the federal return.

For a detailed discussion of the apportionment formula, refer to Chapter 27 Apportionment.

(3) Illinois Net Loss / Deduction

An Illinois net loss incurred by a Subchapter S corporation can be carried to a taxable year in which it is a C-corporation, and vice versa. Ref: 86 IAC § 100.2330(f)(4)(B). However, any Illinois net loss incurred by a partnership or S corporation can only be carried and used against that taxpayer’s taxable income. Partnership or S corporation Illinois net losses cannot be applied against the partner or shareholder’s taxable income. Ref: 86 IAC § 100.2330(f)(4)(C).

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For a detailed discussion of INOL Carryforward/Carryback provisions, refer to Chapter 35.

(4) Credits

Refer to corresponding section under Partnerships.

(5) Schedule B Partners' or Shareholders' Identification

Refer to corresponding section under Partnerships

(6) Schedule K-1-P

Refer to corresponding section under Partnerships

(7) Schedule(s) K-1-P(3) Pass-through Withholding Calculation for Nonresident Members

Refer to corresponding section under Pass-through Entity Withholding

f) Nonresident Shareholders

S corporation shareholders, other than residents as defined in IITA § 1501(a)(20), are required to allocate to Illinois their pro-rata shares of so much of the business income of the S corporation which is allocated or apportioned to Illinois in the hands of the S corporation. S corporation shareholders allocate to Illinois their pro-rata shares of the S corporation's nonbusiness income as if such income had been paid, incurred or accrued directly to the shareholders in their separate capacities. That is, with respect to nonbusiness income, a shareholder would use IITA § 303 and 86 IAC § 100.3220 to determine whether an item of nonbusiness income should be allocated to Illinois (IITA § 308).

Note: All corporations (including S corporations) and partnerships are non-residents under the statute because they can never meet the definition of a resident in IITA § 1501(a)(20).

g) Auditor's Report

The Auditor's Report for the IL-1120-ST is Form EDA-93. Schedule B information should be included as an audit schedule.

Any changes to the IL-1120-ST in audit will generally affect every nonresident shareholder's Illinois taxable income and may affect the resident shareholder's

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income. If so, the auditor will be responsible for making the changes to every shareholder's return, unless the S corporation agrees to pay the tax by filing an IL-1000 or IL-1023-C if none were originally filed or an IL-1023-C-X or IL-1000-X amending previously filed forms (for tax years ending prior to December 31, 2014) or IL-1120-ST or IL-1120-ST-X, as applicable (for tax years ending on and after December 31, 2014). Additionally, in the course of completing the IL-1120-ST audit, a compliance check must be done to determine if all shareholders are filing Illinois income tax returns.

If taxable income is increased per audit and/or it is determined there are nonresident shareholders who are nonfilers, these shareholders can be referred for audit. They should NOT be referred if there is no tax potential. Refer to Chapter 20 Audit Procedures, Referrals.

If the proposed changes result in a No Liability audit or there is a no liability year within the audit period, the only way to process any line change(s) is to complete an IL-1120-ST-X, attach supporting documentation and have the taxpayer sign it. This procedure must be followed because the taxpayer must be given the opportunity to agree or disagree with PROPOSED changes resulting from an audit. A Notice of Deficiency is issued only when there is an increase (or decrease) in the tax liability.

C. Trusts, Estates and Decedents

Four parties are involved in establishing a trust or estate: fiduciary, beneficiary, trustor (grantor), and/or decedent.

- **FIDUCIARY** - a person who occupies a position of special confidence toward others, such as a trustee, executor and administrator. For Income Tax purposes, a fiduciary is a person who holds in trust an estate to which another has the beneficial title or interest, or receives and controls income of another, as in the case of receivers. REF: CFR § 301.7701-6.

- **BENEFICIARY** - one who is designated to receive benefits; an heir, legatee, devisee.

- **TRUSTOR (GRANTOR)** - the creator of the trust. The creator is usually designated as the grantor of the trust.

- **DECEDENT** - the deceased person whose estate is at issue.

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TRUSTS

A trust is a legal arrangement created by a will or an inter vivos declaration under which trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery and probate courts. Beneficiaries usually do nothing more than accept the trustee benefits. REF: CFR § 301.7701-4(a).

A trust is created when money, securities, or property (corpus) is committed or entrusted (by a grantor) to one (trustee, trust officer, etc.) to be used or cared for in the interest of another (beneficiary(ies)) in accordance with instructions (trust instrument) given when the trust was established.

The following is a list of various terms relating to trusts:

- **SIMPLE TRUST** - generally one which makes no distribution other than current income and the terms of which require all of its income to be distributed in the year it is received (whether or not distributed) and do not provide for charitable or similar contributions. REF: CFR § 1.651(a).

- **COMPLEX TRUST** - one which permits accumulation of income or charitable deductions or which distributes principal. In other words, it is a trust that does not qualify as a simple trust.

- **FAMILY ESTATE TRUST** - also known as a family, pure, equity, equity pure, prime or constitutional trust. This is a trust to which an individual transfers his/her personal assets and right to income in exchange for the benefit of the assets and compensation being taxed as a grantor trust. These trusts are deemed a "nullity" for income tax purposes. Their income is taxable to the persons who created the trusts.

- **IRREVOCABLE TRUST** - one that may not be revoked after its creation.

- **TESTAMENTARY TRUST** - a trust created by a will. It takes effect upon the death of the grantor.

- **INTER VIVOS TRUST** - a trust which becomes operative during the grantor's lifetime.

  An **INTER VIVOS SIMPLE TRUST** is operative during the grantor's lifetime and the trust instrument provides that all income of the trust including capital gains be distributed currently, and the trust is not permitted to make charitable contributions.

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In an inter vivos trust, the basis of the property received from the grantor generally is the same as it would be in the hands of the grantor and the holding period also includes the grantor's holding period. The basis of property received by an estate or a testamentary trust is its fair market value at the date of death of the grantor (or the alternate valuation date for estate tax purposes). The holding period begins with the date of death.

- **REVOCABLE TRUST** is defined as when "the grantor of a trust reserves the power to take back title to the trust funds for himself… "The grantor is taxable on the trust income if he can exercise that power. REF: IRC § 673(a).

Trust property is referred to as the corpus or principal. Income from the principal such as interest, cash dividends, or rent is distributed to beneficiaries.

A trust is generally considered to have terminated when the property held in trust has been distributed, except for a reasonable amount which is set aside in good faith for the payment of unascertained or contingent liabilities and expenses. The happening of the event by which the duration of the trust is measured does not automatically terminate the trust. For example, if a trust is to terminate upon the death of the beneficiary and the corpus is to be distributed to the remainderman, the trust continues for a reasonable period to allow the trustee to settle the affairs of the trust. However, settlement of the trust cannot be unduly postponed and if distribution of the trust corpus is unreasonably delayed, the trust is considered terminated for federal income tax purposes after the expiration of a reasonable period for the trustee to complete the administration of the trust. REF: CFR § 1.641(b)-3(b).

If the trust is considered terminated for federal income tax purposes because the administration has been unduly prolonged, the gross income, deduction and credits of the trust are, subsequent to termination, considered the gross income, deductions and credits of the person(s) succeeding to the property of the trust. REF: CFR § 1.641(b)-3(d).

ESTATES

An estate is created by a person's death and consists of the assets and liabilities of the decedent. The assets and liabilities are entrusted to one (administrator, executor, etc.) who uses and cares for the property for the interest of another (beneficiary(ies), heir(s), legatee(s)) in accordance with provisions of a last will and testament or in accordance with state law.

- **EXECUTOR (EXECUTRIX)** - named in a decedent's will to administer the estate and distribute properties as the decedent has directed.

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- **ADMINISTRATOR (ADMINISTRATRIX)** - usually appointed by the court if no will exists, if no executor was named in the will, or the named executor cannot or will not serve.

- **PERSONAL REPRESENTATIVE** - of an estate can be an executor, administrator, or anyone who is in charge of the decedent's property.

- **FIDUCIARY** - persons who have positions of trust on behalf of others. A fiduciary is a person who occupies a position of special confidence towards another, who holds in trust property in which another person has the beneficial title or interest, or who receives and controls income of another. Trustees, executors and certain receivers are considered fiduciaries. An executor or administrator is a fiduciary. However, an "agent" is not a fiduciary for federal income tax purposes, even though a "fiduciary relationship" may be said to exist for state law purposes.

In general, an executor and an administrator perform the same duties and have the same responsibilities.

The estate's income must be reported on an annual basis; either on a calendar or fiscal year. The executor or administrator chooses the estate's accounting period when they file the first income tax return. An estate's first tax year may be any period that ends on the last day of a month and that does not exceed 12 months.

1. Federal Taxation - Trusts/Estates/Decedents

Estates and trusts are considered to be fiduciaries under federal tax law and are generally treated as separate and independent taxpayers.

An estate or trust is considered to be a "conduit" of the income which it distributes, or is required to distribute, to its beneficiaries. Trust or estate income is therefore taxed either:

- To the fiduciary (the estate or trust), if retained; or
- To the beneficiary, if distributed.

The "character" of the income which is passed on to the beneficiaries is preserved so that it has the same tax attributes in the beneficiary's hands as when received by the fiduciary. Each beneficiary is considered to receive a pro rata share of each class of trust income (dividends, taxable interest, tax-exempt interest, rents, capital gains, etc.)

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- **DISTRIBUTABLE NET INCOME (DNI)** - the amount that sets the limit on the deduction of a domestic estate or trust for distributions to beneficiaries. It may also limit the amount of the distribution which is taxable to the beneficiary. The distributable net income of a domestic estate or trust generally consists of the same items of gross income and deductions that make up the taxable income of the estate or trust. See IRC § 643(a) for further information.

- **DISTRIBUTED INCOME** - that amount which is distributed to the beneficiary(ies) in a given taxable year. It includes amounts paid out of income or corpus. "Corpus" means a payment made which results in the reduction of the principal. The deduction (modification) claimed by the trust or estate cannot exceed the DNI.

- **UNDISTRIBUTED INCOME** is the amount of income retained by the trust with certain limitations.

Trusts and estates are taxable "persons" under the IRC. They must file income tax returns and a variety of information returns in the same general manner as any other taxpayer. For example, if a trust or estate conducts a business, it must file the same information returns that are required of all businesses which make certain types of business payments or enter into certain transactions.

Returns for a trust are filed by the trustee; returns of estates are filed by the executor or administrator. These representatives are collectively referred to as "fiduciaries."

Federal Treatment

The returns required by fiduciaries on behalf of their trusts or estates are discussed in the following paragraphs.

Trusts and estates must obtain a federal employer identification number (FEIN) which is used on all returns they are required to file. The fiduciary (trustee, executor, or administrator) does not use his own personal account number on fiduciary returns. On income tax returns and related documents, trusts and estates show their own employer number and the identifying number of each beneficiary.

In the case of a revocable trust whose income is charged to the grantor (creator of the trust), both the trust's number and the grantor's number should be given. If there is no trust under local law, the grantor's number is enough.

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a) Federal Taxation - Trusts

A trustee must file a federal Form 1041 if the trust is not tax-exempt and if:

- The trust has any taxable income for the year; or
- The trust has gross income of $600 or more; or
- Any beneficiary is a nonresident alien.

A trustee of several trusts must file separate returns for each trust meeting the above requirements, even though all the trusts have the same grantor and beneficiary. REF: CFR § 1.6012-3(a)(4).

Trust income taxable to the grantor (where he is considered to be the owner) is reported on a separate statement attached to federal Form 1041. REF: CFR § 1.671-4(a)

Where an executor transfers part of the estate's assets to a trustee and retains other assets in the estate, each must file a separate Form 1041 reporting the income received by each.

A trustee of an otherwise exempt trust must file a federal Form 990T for each taxable year that the trust has gross income of $1,000 or more included in computing "unrelated business taxable income." REF: CFR § 1.6012-3(a)(5).

COMMON TRUST FUNDS

A bank often maintains a common trust fund to invest funds held by it as trustee, executor, etc. The bank must make a return of income and deductions each year with respect to the common trust fund regardless of the amount of income. Federal Form 1065 (a partnership return) may be used for this purpose, but it should be marked "Common Trust Fund" at the top. The return must include the names, addresses and shares of the participants. REF: CFR § 1.6032-1.

b) Federal Taxation - Estates

In addition to the duty of filing the decedent's final return, an executor or administrator must file returns for the estate from the date of decedent's death until the estate is liquidated and the assets distributed. An estate's income tax return is filed on federal Form 1041. A return is required if gross income for the estate's taxable year is $600 or more, or if any beneficiary is a nonresident alien.

A nonresident alien (NRA) estate required to file a US income tax return for income from US sources must file using a federal Form 1040NR.

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If there are executors or other fiduciaries in several states, the executor who probates the entire will (in the state where the decedent was domiciled) files the federal Form 1041 reporting all the income. The out-of-state or "ancillary" executor also files a federal Form 1041, but it merely refers to the main federal Form 1041 and shows the gross income received by the ancillary fiduciary and the deductions attributable to such income. REF: CFR § 1.6012-3(a)(3).

c) Federal Taxation - Decedents

A final income tax return must be filed for a deceased person (decedent) who would be required to file if alive for the part of the year up to the date of his death. Income received after his death is reported by the recipient.

A decedent's final return is filed by the person entrusted with his property. Ordinarily, this would be the executor or administrator of his estate, and if such a fiduciary is appointed, he will be responsible for decedent's final return.

Usually the surviving spouse will file a decedent's return if there is no executor or administrator. A surviving spouse may also file a joint return for the decedent's final year and the joint return rate may be used for the two following years if dependent children are claimed.

A decedent's final return is due at the same time his return would have been due had he lived.

As to the type of return, filing extensions, payment of the tax, etc., the rules are the same as for individuals.

> Example: D dies on April 1, 1987. If he filed using the calendar year, his final return covering January 1 – April 1, 1987 is due April 15, 1988. If he was on a fiscal year ending June 30, 1987, his final return is due October 15, 1987.

d) Federal Form 1041

Federal Form 1041 is filed by an estate or trust. It is a tax PAYING return and not merely a tax INFORMATION return (as is the partnership federal Form 1065). Nevertheless, amounts of income paid, credited or distributable to the beneficiaries are allowed as deductions before the computation of the tax on federal Form 1041. The beneficiaries pay the tax on such amounts on their individual federal Form 1040s. The following chart facilitates an understanding of federal Form 1041.

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GROSS INCOME	Dividends Interest Income from Partnerships and other Trusts and Estates** Rents and Royalties Sale or Exchange of Property Trade or Business Net Profit
Minus	
DEDUCTIONS FROM GROSS INCOME	Interest Taxes Contributions (Schedule A – Deductible by Estate or Complex Trust Only) Administrative Expenses Depreciation and Depletion Casualty Losses Net Operating Loss Deduction
Equals	
BALANCE (NET INCOME)	
Minus	
AMOUNTS DISTRIBUTABLE TO BENEFICIARIES	Amounts Required to be Distributed Other Amounts Properly Paid or Credited
And minus	
EXEMPTION	Estate, $600; Trusts Which Must Distribute All Income Currently, $300; Other Trusts, $100
Equals	
TAXABLE INCOME	

** All income or losses from partnerships and other estates, or trusts is entered on line 3 except:
a. interest (which are entered on line 1)
b. dividends (which is entered on line 2)
(effective for tax years 1990 and forward)
c. capital gains or losses (which are entered on Schedule D)
d. ordinary gains or losses (which are entered on Form 4797)

If an estate or trust has tax-exempt income, the amounts deducted from gross income are reduced by the allocable portion attributable to tax-exempt income.

Schedule A of federal Form 1041 is used to determine the charitable contribution deduction for an estate or trust. Estates and complex trusts are allowed an unlimited charitable deduction for amounts that are PAID to recognized charities

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out of gross income under the terms of the governing instrument during the tax years. REF: IRC § 642(c).

Schedule B is the computation of the income distribution deduction. DNI limits the deduction allowable to estates and trusts to amounts paid, credited, or required to be distributed to beneficiaries. It is used to determine how much of an amount paid, credited, or required to be distributed to a beneficiary will be includable in his or her gross income and, therefore, deductible from the taxable income of the estate or trust.

In general, a fiduciary must file a return on federal Form 1041 on behalf of the trust or estate for which he or she acts when:

- The gross income of the estate or trust for the taxable year is $600.00 or more before making deductions allowed or amounts paid or distributed to the beneficiary or beneficiaries,

- A trust has gross income of $600.00 or more regardless of the amount of taxable income or has any taxable income after all deductions including distribution to beneficiaries for the taxable year, or

- Any beneficiary of the estate or trust is a nonresident alien.

Gains and losses from a sale or exchange of property are computed and allocated between the fiduciary of the estate or trust and the beneficiaries on separate federal Form 1041, Schedule D's.

A beneficiary's share of income, deductions, and credits is shown on a separate Schedule K-1 for each beneficiary. Beneficiaries must include in their gross income, the smaller of (1) the amounts paid, credited or required to be distributed to them, or (2) their proportionate share of distributable net income reduced in either case by their share of distributable tax-exempt income minus the allocable expense not allowable as a deduction on federal Form 1041. Further, the character of the income reported on each separate Schedule K-1, by the fiduciary, shall be the same as the items that enter into the computation of the distributable net income.

A federal Form 1041, Schedule K-1 (or an acceptable substitute) is filed for each beneficiary.

If the total of the amounts paid or credited, which are required to be distributed, are more than the amount of the distributable net income shown in Schedule C, then the amounts that go into the computation of the distributable net income are

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reported on each Schedule K-1 in proportion to each beneficiary's share of income.

If the total payments, credits and required distributions are less than the distributable net income, however, only a proportionate part of each item entering into the computation of distributable net income is reported on Schedule K-1, according to the ratio of each particular item of income to the distributable net income.

The term "income" as used for estates and trusts, when not preceded by the words "taxable", "distributable net", "undistributed net" or "gross" means the income of the estate or trust as determined under its governing instrument and the applicable local law. In other words, "income" usually means the amounts for which the fiduciary would be required to account for in rendering an accounting to the court having jurisdiction over the estate or trust. Items of gross income constituting extraordinary dividends or taxable stock dividends, which the fiduciary, acting in good faith, allocates to the corpus are not considered income. REF: IRC § 643(b).

The (Federal) Tax Reform Act of 1986 made some changes in the law regarding trusts and estates. The following is a brief synopsis:

- The "grantor trust" rules were modified. The new law expands the grantor trust rule to include trusts where the assets will revert to the grantor or the grantor's spouse (under certain conditions). This will not apply in a situation where the beneficiary is a lineal descendant of the grantor and the reversion occurs upon the death of the beneficiary before the beneficiary reaches age 21. REF: IRC § 673(b).

The following are federal changes that affect 1986-87 fiscal year and 1987 year filers:

- The 60% capital gains deduction for estates and trusts was repealed for tax years beginning after December 31, 1986.

- For tax years beginning after December 31, 1986, Section 1403 of the IRC required fiscal year trusts, other than wholly tax-exempt trusts and charitable trusts, to adopt a calendar tax year. This resulted in a short year return being filed in 1987. A beneficiary who had to pick up the short-period income as a result of this change was allowed a four-year spread of the income beginning with his/her first taxable year after 1986. Taxpayers using the four-year pro-ration method include on their federal Form 1040 their distributive share of

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income from the fiscal year return K-1 and 1/4 of the income shown on the short-year Schedule K-1.

Illinois is bound by the taxpayer's federal treatment of the short-year income as reflected in the taxpayer's AGI. Taxpayers receiving tax exempt federal interest and electing the four-year pro-ration will be allowed to pro-rate their state and local interest from the short-year period over the next four years for Illinois purposes. REF: Sunshine Letter IT 88-0092.

A four-year pro-ration of income received by a beneficiary as a consequence of a trust's change in taxable year as required by Section 1403 of the Tax Reform Act of 1986 is allowed in Illinois if it is done federally because the Illinois computation begins with income based on a 4-year pro-ration. Illinois follows the federal method. Ref: Sunshine Letter IT88-0044.

- The federal Form 1041 changed in 1987 in that the total amount of tax-exempt interest received must be reported in "other information".

- For tax years beginning after December 31, 1986, IRC § 469 provides for limitations on losses and credits from a passive activity. Section 469 generally limits deductions and credits derived from passive activities to the amount of income derived from all passive activities. A passive activity is any trade or business activity of the estate or trust in which the fiduciary does not materially participate. A passive activity also includes any rental activity where payments are primarily for the use of tangible property. Passive activities do not include working interests in oil and gas property (as defined in IRC § 469(c)).

e) Passive Activity Loss and Credit Limitations

Passive activity rules apply to:

- Individuals,
- Estates,
- Trusts (other than grantor trusts),
- Personal service corporations, and
- Closely held corporations.

Even though the rules do not apply to grantor trusts, partnerships and S corporations directly, they do apply to the owners of these entities.

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As part of a federal attack on tax shelters, the Tax Reform Act of 1986 added a new provision to the IRC which restricts sheltering earned income and portfolio income with losses or credits arising from "passive activities." There are three categories of income and loss:

- Passive Activity Income or Loss --IRC §469(c) identifies two types of passive activities:

  - Trade or business activities in which the partner did not "materially participate" during the tax year. Material participation is involvement in operations of the activity on a regular, continuous, and substantial basis. All limited partnership interests are treated as not materially participating.

  - Rental activities regardless of the level of participation.

    An activity is classified as a rental activity if the tangible property is used (or held for use) by customers; and the gross income arising from the activity represents amounts paid principally for the use of the tangible property. There are six exceptions to rental activity being treated as passive. If any of them are met, the rental of the property is not considered to be a rental activity, and the income is treated as ordinary income of the partnership. REF: Section 1.469-1T(e)(3)(B)(ii) of Temporary Federal Income Tax Regulations.

    Rental real estate activity is a rental activity that involves the retailing or leasing of real estate. However, where significant services are provided in connection with the rental of real estate (such as the renting of hotel rooms), the activity is treated as a trade or business and not a rental real estate activity.

- Portfolio Income or Loss —IRC § 469(e)(1) provides that portfolio income is not derived in the ordinary course of a trade or business, and therefore, must be stated separately on Schedule K-1.

- Active Income or Loss --Income originating from all activities in which the partner materially participated and which are not included above.

A passive activity is generally one that involves the conduct of a trade or business or any investment activity in which the taxpayer does not materially participate. Passive activity losses can only be used to offset passive activity income. The new law generally applies without regard to when the passive activity was acquired, but a five year phase-in is provided for interests held as of October 26, 1986 (the date of enactment).

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The passive loss limitation generally allows losses and credits from passive activities to be used only against income or tax from passive activities. The limitation is effective for tax years beginning after 1986. Interests in passive activities acquired by a taxpayer before October 23, 1986 are called "pre-enactment interests" and are eligible for a gradual phase-in of the passive activity loss limitations. During this phase-in period, a certain percentage of the taxpayer's pre-enactment losses are allowed as an offset to non-passive income.

The percentage of the passive activity loss that is allowed to offset non-passive income for each year of the phase-in period is as follows:

Year	Percentage Deductible
1987	65%
1988	40%
1989	20%
1990	10%
1991	0%

REF: IRC § 469(m)

The determination of whether or not a partner/shareholder materially participated in an activity is made by each partner/shareholder. As a result, while the partnership's/S-corporation's overall trade or business income (loss) is reported on page one of the federal Form 1065/IL-1120-S, the specific income and deductions from each separate trade or business activity must be reported on attachments to the federal Form 1065/IL-1120-S. If an activity is a passive activity for a particular partner/shareholder, that partner/shareholder is subject to the passive activity limitation for federal purposes.

An estate or trust is treated as materially participating in an activity if an executor or fiduciary, in the capacity as such, is involved in operations of the activity on a regular, continuous and substantial basis. In the case of a grantor trust, however, material participation is determined at the grantor level.

The passive activity loss (also referred to as PAL) limitation does not apply to the partnership or S corporation, but rather to each partner's or shareholder's share of any loss or credit attributable to a passive activity. Corporations that are not closely held are not subject to any PAL limitation. The PAL limitations also do

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not apply to partners or shareholders holding a working interest in an oil or gas well, where the partner/shareholder holds the interest through an entity that does not limit the partner's liability.

Portfolio income is passive income and may not generally be offset by passive activity income, but portfolio losses may offset passive activity income and active income, because portfolio investments do not afford the opportunities for "tax sheltering" that caused Congress to enact the passive activity loss limitation rules.

Passive activity losses that are not deductible for a particular tax year because there is insufficient passive activity income to offset them (i.e., suspended losses) are carried forward indefinitely and are allowed as deductions against passive activity income in subsequent years. Unused suspended losses are allowed in full upon a fully taxable disposition of the entire interest in the activity (IRC § 469(g)); however, such losses must first be applied against the taxpayer's net income or gain from other passive activities.

f) At-Risk Limitations

"At-risk" rules have been in existence since 1976; however, they have been refined several times since then. "At-risk" rules were designed to prevent investors from sheltering trade, business or professional income by generating losses from investments in activities that were financed largely through non-recourse loans for which they were not personally liable. "At-risk" rules limit losses which can be deducted to the amount the partner has at risk and could actually lose from the activity.

"At-risk" rules apply only to individual (noncorporate) taxpayers, including partners in partnerships and shareholders in S Corporations. The rules are extended to certain closely-held C corporations, in which five or fewer shareholders own more than 50% of the stock. REF: IRC § 465(a)(1).

"At-risk" rules have been largely overshadowed by the more stringent "passive activity loss" rules, but still play an important part for many partners and Subchapter S corporation shareholders. Taxpayers who materially participate in a non-rental business activity are "active investors" for purposes of the passive activity loss rules. These taxpayers are not affected by the passive activity loss limitation rules but may well have insufficient amounts "at-risk" in the business to support a current loss deduction. The amount of partnership loss (including capital loss) that may be allowed to a partner is limited to the amount of the adjusted basis (before reduction by the current year's loss) of his interest in the partnership at the end of the partnership taxable year in which the loss occurred. REF: 26 CFR §1.704-1(d).

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At-risk rules must be applied before the passive activity rules.

Partnerships

IRC § 704(d) provides that a partner's distributive share of partnership losses is allowed as a current deduction only to the extent of the partner's adjusted basis in his partnership interest as of the close of the partnership's tax year in which the loss occurred. If the total amount of the loss allocable to the partner for a year exceeds the partner's remaining adjusted tax basis, the excess loss will be allowed as a deduction to the partner at the end of the partnership year in which the excess is repaid to the partnership.

S Corporations

S corporation shareholders are generally subject to the same at-risk limitations as partners.

Under IRC § 1366(a), gains and losses from an S corporation's sale or exchange of assets pass directly through to the shareholders and retain their corporate characteristics. The pro rata share of gains and losses is carried to the respective shareholder's return and combined with any other gains and losses on the shareholder's individual return. Thus, if corporate losses exceed gains, a shareholder can use them to offset other income, subject to the at risk limitations. For corporations electing to be S corporations before January 1, 1987, the total capital gains may not always be passed through to the shareholders.

Estates

In the case of taxable years of an estate ending less than two years after the date of death of the decedent, up to $25,000 of deductions and credit equivalents attributable to all rental real estate activities in which the decedent actively participated is allowed. Any unused losses and/or credits are deemed "suspended" passive activity losses for the year, and are carried forward indefinitely.

Generally, the amount the estate or trust has "at-risk" limits the amount of loss which can be deducted for any tax year. When the losses are deductible under the "at-risk" rules, the passive activity rules then apply.

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2. Illinois Taxation - Trusts and Estates

Illinois requires the fiduciary of an estate or trust to file Form IL-1041, if:

- the estate or trust has Illinois net income or loss, without regard to any deductions to beneficiaries, or
- if the estate or trust is a resident of the State of Illinois, and is required to, or does file a Federal income tax return, or
- is a nonresident of Illinois but received income from Illinois sources which was not reported:
  - on Form IL-1000 (for tax years ending prior to December 31, 2014)
  - as pass-through withholding on Form IL-1120-ST, Form IL-1065 or Form IL-1041(for tax years ending on and after December 31, 2014)

An estate or trust does not have to file estimated tax returns.

The term "RESIDENT", for the purpose of fiduciary returns, has been defined in the IITA as follows:

- The estate of a decedent who at his or her death was domiciled in Illinois. REF: IITA § 1501(a)(20)(B).

- A trust created by the will of a decedent who at his death was domiciled in Illinois. REF: IITA § 1501(a)(20)(C).

- An irrevocable trust, the grantor of which was domiciled in Illinois at the time the trust became irrevocable. REF: IITA § 1501(a)(20)(D). A trust is considered irrevocable to the extent that the grantor is not treated as the owner thereof under IRC § 671-678.

Due to varying state laws, a trust could be a resident of Illinois and a resident of some other state at the same time.

Illinois does not determine the residency of a trust by the residency of the trustee. A resident trust must file an IL-1041 if it files a federal Form 1041 even though the trust currently has no nexus and earns no income in Illinois.

Note: Under the decision in Linn v. Department of Revenue, 2 N.E. 3d 1203 (2013), an inter-vivos trust whose trustee and beneficiaries were outside Illinois and which conducted all its activities outside Illinois did not have sufficient nexus with Illinois to be subject to tax, even though the grantor was an Illinois resident, making the trust an Illinois resident. Since that decision was rendered, the Department has conceded this issue in other cases. If a trust asserts it is not

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subject to tax under this decision, and it is not clear whether or not the Linn case applies, the matter should be referred to the supervisor.

a) Grantor Trusts

Under IITA § 205(e), "grantor trusts" are exempt from Illinois income taxation and, therefore, are not required to file IL-1041's. Because the grantor is treated as receiving the income of the trust directly, the federal income and any additions and subtractions are not pass-through items. Grantor trusts are not required to file returns, withhold on pass-through income, or issue Schedules K-1-T. If a Schedule K-1-P or K-1-T is issued to a grantor trust for 2012 or subsequent years, the schedule has a box in Step 2 for the grantor trust to identify itself as a grantor trust and to identify the grantor, so that the grantor can use the schedule as if it had been issued directly to the grantor. For earlier years, the grantor is required to show that he or she is the grantor of the grantor trust that received the schedule by some other means.

Although a revocable grantor trust is not required to file an IL-1041, it would become an irrevocable trust upon the death of the grantor. If the grantor was domiciled in Illinois at the time of death, it becomes a resident Illinois trust that is required to file form IL-1041. IITA § 1501(a)(20).

b) Charitable Remainder Trusts

For federal purposes, a charitable remainder trust is exempt from federal income tax unless it has unrelated business taxable income within the meaning of IRC § 512. If it files a federal Form 1041, it is required to file an IL-1041 regardless of whether or not it is liable for Illinois income tax. However, unless a charitable remainder trust has income taxable at the federal level due to unrelated business income, it will have no base income to compute Illinois income tax liability.

If a trust is only required to file federal information Forms 1041-A and 5227 because it does not have any unrelated business income, federal Form IL-1041 is not required to be filed. Information forms are not included within the definition of federal tax returns as that term is used in IITA § 502(a)(2).

c) Audit Procedures

Line 1 of the IL-1041 should be verified with the taxable income on the federal Form 1041. Beneficiaries are not subject to all of the modifications to which the estate or trust is subject. The modifications in column A are for beneficiaries and those in column B are for fiduciaries (for tax years 2007 and forward).

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The BENEFICIARY'S SHARE of each of the items is the amount thereof which was properly paid, credited or required to be distributed to the beneficiary for the taxable year. The items of income and deduction and the additions and subtractions that are deemed to have been paid, credited or distributed must be taken into account by the beneficiaries in proportion to their respective shares of the distributable net income of the trust or estate for the taxable year.

The FIDUCIARY'S SHARE of an item of income (and any deductions attributable thereto) is that amount which is required to be taken into account by the fiduciary (trust or estate) in computing fiduciary taxable income for Federal tax purposes for the taxable year and which is not paid, credited or required to be distributed to the beneficiaries of the trust or estate for such year. The fiduciary's share of the items of addition and subtraction required under the Illinois Income Tax Act is that part of each of such items which relates to and is attributable to the fiduciary's share of the items of income and deduction.

d) Modifications

Federal taxable income is then modified per IITA § 203(c)(2) to arrive at base income. The following paragraphs describe the modifications and their effective and termination dates, where applicable.

(1) Additions

Refer to Exhibit K and Exhibit L for an example of a 2017 IL-1041 and Schedule M addition line and cite reference.

(a) Federally Tax-Exempt Interest Addition
(IITA § 203(c)(2)(A))

For a detailed discussion of this modification, refer to Chapter 24.

To verify this addition modification, refer to the beneficiaries' shares of the “tax-exempt interest” shown on all Schedule K-1s issued by the estate or trust. (On the 2013 Schedule, this information is found in Box 14 under Code A.) The total tax-exempt interest from all Schedule K-1s should equal the amount shown on the IL-1041, Column A, Beneficiaries. To verify the Column B, Fiduciary amount, refer to federal Form 1041. For tax years beginning after 1986, any taxpayer required to file a federal Form 1041 must report as an item of information, the amount of the tax-exempt interest received or accrued during the tax year. Subtract the beneficiaries' share from the total listed on the federal Form 1041 to obtain the fiduciary’s share of tax-exempt interest. The income shown here is net of allocable expenses. It may or may not be net of amortization of bond premium. When auditing a

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nonfiler for prior years, the detailed records of the trust must be examined to determine tax-exempt interest amount.

(b) Exemption Addition
(IITA § 203(c)(2)(B))

Requires an addition modification in the amount of: "in the case of (i) an estate, $600; (ii) a trust which, under its governing instrument is required to distribute all of its income currently, $300; and (iii) any other trust, $100, but in each such case, only to the extent such amount was deducted in the computation of taxable income."

The amount of the addition is the exemption deduction shown on Page 1 of the federal Form 1041.

(c) Illinois Income Tax Deducted Addition
(IITA § 203(c)(2)(C))

Provides an addback for "An amount equal to the amount of tax imposed by this Act to the extent deducted from gross income in the computation of taxable income for the taxable year."

Although state and federal income tax is not imposed on income distributed or deemed distributed to beneficiaries, a trust can allocate the state tax expense to its beneficiaries, so that this addition flows through to them rather than remaining with the trust. It can be verified from a breakdown of the tax expense line on Page 1 of federal Form 1041.

For a detailed discussion of this addition, refer to Chapter 24.

(d) Federal Net Operating Loss Addition
(IITA §203(c)(2)(D))

Provides an addition modification for "The amount of any net operating loss deduction taken in arriving at taxable income, other than a net operating loss carried forward from a taxable year ending prior to December 31, 1986."

This modification was added to the IITA by PA 84-1042 and is effective for tax years ending on or after December 31, 1986.

An in-depth discussion of this modification can be found in Chapter 35.

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(e) Excess Addition Modification
(IITA §203(c)(2)(E))

Provides an addition modification:

> For taxable years in which a net operating loss carryback or carryforward from a taxable year ending prior to December 31, 1986 is an element of taxable income under paragraph (1) of subsection (e) or subparagraph (E) of paragraph (2) of subsection (e), the amount by which addition modifications other than those provided by this subparagraph (E) exceeded subtraction modifications in such taxable year, with the following limitations applied in the order that they are listed:
>
> > (i) the addition modification relating to the net operating loss carried back or forward to the taxable year from any taxable year ending prior to December 31, 1986 shall be reduced by the amount of addition modification under this subparagraph (E) which related to that net operating loss and which was taken into account in calculating the base income of an earlier taxable year, and
> >
> > (ii) the addition modification relating to the net operating loss carried back or forward to the taxable year from any taxable year ending prior to December 31, 1986 shall not exceed the amount of such carryback or carryforward;
>
> For taxable years in which there is a net operating loss carryback or carryforward from more than one other taxable year ending prior to December 31, 1986, the addition modification provided in this subparagraph (E) shall be the sum of the amounts computed independently under the preceding provisions of this subparagraph (E) for each such taxable year.

This section was added to the IITA by PA 83-591 effective December 1, 1983. PA 84-1042 (as reflected above) amended this section to delete all references to "such earlier or later taxable year(s)" and restricted the modification to net operating loss carrybacks or carryforwards from taxable years ending prior to December 31, 1986.

This addition modification is reported on Schedule M as “Other Additions”.

For an in-depth discussion refer to Chapter 35 on Net Operating Losses.

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(f) Other States' Income Tax Addition
(IITA § 203(c)(2)(F)

Provides for the following addition modification:

> For taxable years ending on or after January 1, 1989, an amount equal to the tax deducted pursuant to Section 164 of the Internal Revenue Code if the trust or estate is claiming the same tax for purposes of the Illinois foreign tax credit under Section 601 of this Act. This addition modification was added by PA 85-1200, effective August 24, 1988.

The effect of this modification is to add back income tax expense deducted from taxable income if that same tax is taken as a credit against the Illinois Income tax liability. For instance, if a resident trust pays income tax to another state on income which is also taxed by Illinois, the tax claimed as a credit on Schedule CR will be added back in arriving at base income. [Note: The statute expressly provides that the credit is allowed only against regular income tax, not replacement tax. However, under Maryland v. Wynne, 135 S. Ct. 1787 (2015), failure to allow a credit against replacement tax violates the Commerce Clause. For 2015 and future years, the Schedule CR will allow the credit against replacement tax, but only after all of the taxpayer's regular income tax has been eliminated by the credit.]

This addition modification is reported on Schedule M.

(g) Capital Gains Addition
(IITA § 203(c)(2)(G))

Refer to corresponding addition modification under Partnerships.

(h) Remediation Costs Addition
(IITA § 203(c)(2)(G-5))

For a detailed discussion of this modification refer to Chapter 24.

The credit under IITA 201(l) (which expired on 1/1/2002) was calculated on Schedule 1299-D and reported in Part IV on Form IL-1041. The addition modification was reported in Part I on the "Other Additions" line of Form IL-1041.

(i) Federal Bonus Depreciation
(IITA § 203(c)(2)(G-10))

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For a detailed discussion of this modification, refer to Chapter 24.

(j) Bonus Depreciation – Reversal of Subtraction on Disposition or End of Depreciable Life

(IITA § 203(c)(2)(G11))

For a detailed discussion of this modification, refer to Chapter 24.

(k) Related Party Expenses

(IITA §§ 203(c)(2)(G-12) and (G-13))

For a detailed discussion of this modification, refer to Chapter 24.

(l) Captive Insurance Companies

(IITA § 203(c)(2)(G14))

For a detailed discussion of this modification, refer to Chapter 24.

(m) Section 218 College Prepaid Tuition Credit Addition

(IITA § 203(c)(2)(G-15))

For a detailed discussion of this modification, refer to Chapter 24.

The credit is calculated on Schedule 1299-D and reported in Step 6 on the Form IL-1041. The addition modification is reported on Schedule M and included in Step 2 on the Other additions line on the Form IL-1041.

(n) Domestic Production Activities Deduction

(IITA § 203(c)(2)(G-16)

Effective for tax years ending on or after December 31, 2017, requires an addition for the federal deduction amount allowed under IRC Section 199 as included on Line 15a of federal Form 1041.

The amount of the addition is reported on Schedule M.

(26 U.S. Code § 199 – repealed. Pub. L. 115-97, title I, § 13305 (a), Dec. 22, 2017, 131 Stat. 2126) for tax years beginning after December 31, 2017)

(o) Distributive Share of Additions

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Includes the trust or estate's distributive share of additions from any other trust or estate of which this trust or estate is a beneficiary; and its distributive share of additions from any partnership or subchapter S corporation in which this trust or estate is a partner or shareholder. In each instance, the trust or estate should have received a Schedule K-1-P or K-1-T from each entity identifying its distributive share of additions. If the entity which distributes the income files an Illinois return, the trust or estate's share of additions can be verified per the applicable schedule attached to that return.

(p) IRC § 965 Transition Tax

(Refer to section on Partnerships for a description of this modification)

For 2017, the IRC § 965 income is reported to the IRS on a statement separate from the federal income tax return. Due to the nature of the separate statement, this income may not be included in the federal taxable income. However, it must be included when determining Illinois Base Income. If the income was not included in the federal taxable income, an Illinois taxpayer must make the appropriate modifications.

Trusts and Estates who retain income are required to make the following modification for tax year 2017:

	IRC 965 Transition Tax Statement	Form IL-1041 Schedule M
IRC § 965 (a)	Line 1	Line 10
IRC § 965 (c)	Line 3	Line 10

Attached the Statement to your return.

For 2018 tax years and after, the foreign earnings are included in the federal taxable income.

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(2) Subtractions

(a) Retirement Payments (Pension Plans) Subtraction
(IITA § 203(c)(2)(H))

This subtraction modification, added by PA 77-669 and effective for all taxable years beginning after December 31, 1970, provided a subtraction modification for:

> an amount equal to all amounts included in such total pursuant to the provisions of Sections 402(a), 402(c), 402(d), 403(a), 403(b), 405(d), 406(a) and 407(a) of the Internal Revenue Code, but only to the extent such amount is determined, under regulations prescribed by the Department, to be attributable to benefits accrued (whether or not vested) during plan years beginning before August 1, 1969 by or on behalf of the employee with respect to whom such amounts are received.

PA 77-2062 effective for taxable years beginning after December 31, 1971 changed this section to read: "an amount equal to all amounts included in such total pursuant to the provisions of Sections 402(a), 402(c), 402(d), 403(a), 403(b), 405(d), 406(a) and 407(a) of the Internal Revenue Code or included in such total as distributions under the provisions of any retirement or disability plan for employees of any governmental agency or unit."

PA 76-1426, effective for taxable years ending after December 31, 1976, added Sections 408 and 409 of the IRC to this modification.

PA 83-1498, effective December 27, 1984 changed this section to read: "an amount equal to all amounts included in such total pursuant to the provisions of Sections 402(a), 402(c), 402(d), 403(a), 403(b), 405(d), 406(a), 407(a), 408 and 409 of the Internal Revenue Code or included in such total as distributions under the provisions of any retirement or disability plan for employees of any governmental agency or unit, or retirement payments to retired partners, which payments are excluded in computing net earnings from self-employment by Section 1402 and regulations adopted pursuant thereto."

PA 85-731, effective for taxable years ending on or after December 31, 1987, amended the section by removing the references to IRC §§ 402(d), 405(d) and 409.

If the taxpayer is claiming this subtraction modification, be sure the income has been included in taxable income on federal Form 1041. This subtraction

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is normally verified during the processing of the return due to the requirement that certain documents to support IL-1041, Line 14 (for tax years 2010 and forward) must be filed with the return.

(b) Valuation Limitation Amount
(IITA § 203(c)(2)(I))

Provides a subtraction modification for the valuation limitation amount effective for taxable years beginning after December 31, 1970. It excludes appreciation attributable to the period prior to August 1, 1969. It is computed on Form IL-1041, Schedule F. Schedule F, Lines 7-9, show the distribution of the pre-August 1, 1969 appreciation amounts in total. Lines 10-18 compute the fiduciary's share which is carried to the IL-1041.

If the IL-1041 is an estate or testamentary trust, there should be no acquisition dates prior to the date of death, and the basis is re-determined as of the date of death. The pre-August 1, 1969 appreciation amounts are determined separately for each beneficiary in Schedule E, but Schedule E must reconcile in total to the Schedule F.

(c) Illinois Income Tax Refund Subtraction
(IITA § 203(c)(2)(J))

Provides for a subtraction for any refund of Illinois income tax for a prior year to the extent it was included in federal taxable income. Effective August 4, 1971.

This subtraction is reported on Schedule M.

When examining this subtraction modification, it is important to verify the amount of the refund which is actually included in the computation of federal taxable income.

(d) Exemptions by Virtue of Statute or Constitution
(IITA § 203(c)(2)(K))

Provides a subtraction modification for "an amount equal to all amounts included in taxable income as modified by subparagraphs (A), (B), (C), (D), (E), (F) and (G) which are exempt from taxation by this State either by reason of its Constitution, treaties, or statutes of the United States".

For a detailed discussion of this modification, refer to Chapter 25.

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Amounts included in this modification will be reported on IL-1041, Step 3, Line 15 and also Schedule M, Step 3, Lines 12, 19 a-q, 28 and 29 (for tax years 2012 and later).

(e) Expense Deductions Disallowed Federally

(IITA § 203(c)(2)(L))

Provides a subtraction modification for expenses related to the investment in federally tax-exempt instruments such as state or municipal bonds.

This subtraction modification is reported on Schedule M.

For a detailed discussion of this modification, refer to Chapter 25.

(f) Enterprise / River Edge Redevelopment Zone Dividends

(IITA § 203(c)(2)(M))

For a detailed discussion of this modification, refer to Chapter 25.

The Enterprise Zone Dividend Subtraction is no longer available for any dividends received on or after August 7, 2012.

This subtraction modification is reported in Step 3 on the IL-1041 and calculated on Schedule 1299-B.

If the fiduciary is a partner in a partnership, a shareholder in an S corporation, or a beneficiary in a trust include its distributive share as reported on K-1-P or K-1-T.

(g) Job Training Project Contributions

(IITA § 203(c)(2)(N))

For a detailed discussion of this modification, refer to Chapter 25.

This subtraction modification is reported in Step 3 on the IL-1041 (for tax years 2007 and after).

(h) Foreign Trade Zone (Sub-Zone)/High Impact Business Dividends

(IITA § 203(c)(2)(O))

For a detailed discussion of this modification, refer to Chapter 25.

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Dividends subtracted under Section 203(c)(2)(M) may not be subtracted under this provision.

When auditing a taxpayer who is claiming this subtraction, be sure to verify that dividends, net of the related special deductions claimed on the federal return, are subtracted, not gross dividend income. Only the amount of dividends included in taxable income may be subtracted. Dividends may only be claimed once (either under the Enterprise Zone modification or the Foreign Trade Zone/Sub-zone modification) even though they may qualify for both.

The subtraction is reported in Step 3 of the IL-1041 and calculated on Schedule 1299-B.

If the fiduciary is a partner in a partnership, a shareholder in an S corporation, or a beneficiary in a trust include its distributive share as reported on K-1-P or K-1-T.

(i) Claim of Right
(IITA § 203(c)(2)(P))

For a detailed discussion of this modification, refer to Chapter 25.

This subtraction modification is reported on the Schedule M, in Step 3 (Line 14 of the 2013 form).

(j) Compensation Paid to Victim of Nazi Persecution
(IITA § 203(c)(2)(Q))

Effective December 23, 1999, PA 91-676 created a subtraction allowing for the amount of compensation paid to a victim of Nazi persecution to be deducted from their federal adjusted gross income.

The subtraction is applicable to taxpayers who are victims or a descendent of a victim of racial or religious persecution by Nazi Germany or any of its World War II allies, if they received compensation for persecution or for resulting losses, and that compensation is included in federal taxable income.

This subtraction is reported in Step 3 of Schedule M (Line 26 of the 2013 form).

The auditor can refer to Information Bulletin FY 2000-15 for more details regarding this subtraction modification.

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(k) Federal Bonus Depreciation
(IITA § 203(c)(2)(R))

For a detailed discussion of this modification, refer to Chapter 25.

The subtraction is calculated on Form IL-4562 and reported on the IL-1041, in Step 3 (Line 20 of the 2013 form).

(l) Bonus Depreciation – Reversal of Subtraction on Disposition or End of Depreciable Life
(IITA § 203(c)(2)(S))

For a detailed discussion of this modification, refer to Chapter 25.

The subtraction is calculated on Form IL-4562 and reported on the IL-1041, in Step 3 (Line 20 of the 2013 form).

(m) Related Party 80/20 and Non-Combination Rule
(IITA §§ 203(c)(2)(T, U, V & Y))

For a detailed discussion of this modification, refer to Chapter 25.

IITA §203(c)(2)(T) allows a subtraction for:

Any interest income (net of expenses) to the extent the payor had to add back the payment under IITA § 203(c)(2)(G-12),

Any income from intangible property (net of expenses) to the extent the payor had to add back the payment under IITA § 203(c)(2)(G-13).

IITA § 203(c)(2)(U), and (V) allow a person who is required to add back interest or intangible expenses paid to a related party under IITA § 203(c)(2)(G-12) or (G-13), respectively, to subtract any interest or intangible interest received from the same related party, up to the amount of the addition. The purpose of these provisions is to require taxpayers to add back only net interest or intangible expense payments if there are payments being made both ways.

IITA § 203(c)(2)(Y) (for tax years ending on or after December 31, 2011) allows a taxpayer who was disallowed a deduction for premiums paid to subtract any loss it would have been allowed to deduct federally if not for reimbursements received on that insurance policy. If the taxpayer elects to take this subtraction, the insurer must add back the reimbursements paid.

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The subtraction is calculated on Schedule 80/20, and reported on IL-1041, in Step 3 (Line 21 of the 2013 form).

For tax years ending on or after December 31, 2017, the non-combination rule is eliminated.

(n) Recovery of Items by a Decedent
(IITA § 203(c)(2)(W))

Effective August 23, 2011, this subtraction modification allows estates to subtract federally taxed recoveries of itemized incomes claimed by the decedent.

This subtraction modification is reported on Schedule M, Step 3 (Line 30 of the 2013 form).

(o) Refund of Taxes Paid to Other States
(IITA § 203(c)(2)(X))

Allows a subtraction for federally taxed refunds of other state's taxes when the trust or estate had added back the federal deduction for the tax when claiming a credit for the taxes.

The modification is reported on Schedule M, Step 3.

(p) Distributive Share of Subtractions

Includes the trust or estate's distributive share of subtractions from any other trust or estate of which this trust or estate is a beneficiary; and its distributive share of subtractions from any partnership or subchapter S corporation in which this trust or estate is a partner or shareholder. In each instance, the trust or estate should have received a Schedule K-1-P or K-1-T from each entity identifying its distributive share of subtractions. If the entity which distributes the income files an Illinois return, the trust or estate's share of subtractions can be verified per the applicable schedule attached to that return.

e) Modification Limitation
(IITA § 203(c)(3))

Provides the following modification limitation effective for tax years ending on or after December 31, 1986:

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> The amount of any modification otherwise required under this subsection shall, under regulations prescribed by the Department, be adjusted by any amounts included therein which were properly paid, credited, or required to be distributed, or permanently set aside for charitable purposes pursuant to IRC § 642(c) during the taxable year.

The effect of this change was to prevent the taxation of income from the addback of capital gains from charitable remainder trusts which permanently set aside such income for charitable purposes.

f) IL-1041 – Schedule NR

(Form for tax year 2016)

If an estate or trust is a NONRESIDENT, then Schedule NR, Form IL-1041 is completed if the estate or trust has any business income derived within Illinois.

Step 3, Column A of Schedule NR reflects the amounts shown on federal Form 1041. Line 5 of federal Form 1041 will be reclassified according to income reported on Schedule NR Line 5 (Net rent and royalty income), Line 6 (Income from partnerships and subchapter S corps), Line 7 (Income from trust and estates) and Line 8 (Real Estate Mortgage Investment Conduits (REMIC)). The total of Lines 5 through 8 on Schedule NR should equal the amount on federal Form 1041 Line 5.

Step 3, Column B is the fiduciary's share of the income and expenses in Column A which are not distributed to the beneficiaries.

Step 3, Column C is the "fiduciary's share" of income allocable to Illinois from Column B. Be sure to verify that each item of income and expense has been properly allocated.

If the fiduciary’s share of any business income was received from both inside and outside Illinois, Step 6 must be completed to figure the apportionment factor, to complete Schedule NR.

Step 4 is completed to figure Illinois additions and subtractions from amounts reported on Form IL-1041, Column B.

Step 5 reflects base income or net loss allocable to Illinois.

If a trust or estate files either federal Schedule 1040 C or F (farming operations), it has business income to be apportioned under IITA § 304. The factor in Step 6 is computed in the same manner as if the estate or trust was a corporation doing business within and without Illinois.

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The sales factor is verified from Schedule C or F as well.

For a detailed discussion of the apportionment factors, refer to Chapter 27 Apportionment.

If all business income is derived solely inside Illinois or solely outside Illinois, Step 6 does not have to be completed.

The exemption available to the nonresident trust or estate is computed in Step 5 of Schedule NR. This amount is then carried to Step 4, Line 31 of the IL-1041.

g) IL-1041 – Step 4

Step 4 and Step 5 of the IL-1041 is the final computation of net income (loss) of the trust or estate and the computation of the trust's replacement tax liability. Resident trusts and estates go straight to Step 4 after completing Steps 2 and 3. IITA § 203(c)(2)(E) provides that effective for tax years ending on or after December 31, 1986, the Illinois Income Tax Act is amended to provide for an Illinois net operating loss which may be carried over or carried back in the same manner as a federal net operating loss.

h) IL-1041--Schedule CR

If a resident trust operates in another state and pays taxes to that state, it may claim a tax credit against its Illinois income tax liability by filing Schedule CR. If a taxpayer files Schedule CR, the amount of taxes claimed on this form is verified by requesting a copy of the other state's income tax return to confirm that the taxes were actually paid.

Resident estates and trusts are entitled to a foreign tax credit for taxes on, or measured by, income paid to another state as defined in the IITA § 601(b)(3) and § 1501(a)(22). Generally, a fiduciary's taxable income is net of income taxes paid in any one of the United States because such taxes are usually claimed as a deduction on the fiduciary's Federal income tax return. However, there may be cases where a fiduciary pays income tax to a foreign country and foregoes the Federal deduction for such taxes in order to claim a credit against their Federal income tax liability. A credit against Illinois Income Tax may then be claimed for such foreign taxes for years ending prior to September 1, 1989.

A fiduciary entitled to claim a foreign tax credit should complete Schedule CR. The schedule should be attached to the IL-1041 for reference. Also, evidence of payment of the foreign tax should be included. If the trust or estate has made distributions to the beneficiary(ies), the amount of such foreign tax credit is

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allocable to both the fiduciary and the beneficiaries on the basis of income distributed.

If a foreign tax credit is claimed for taxes paid to another state (not a foreign country), the credit is not allowable if any of the tax paid to the other taxing jurisdiction and claimed on the IL-1041 Schedule CR was deducted from federal taxable income on federal Form 1041 and was NOT added back on Schedule M, Line 5. REF: IITA § 601(b)(3) and instructions to Schedule CR (IL-1041).

i) IL-1041--Schedule D Beneficiary Information

Schedule D, Beneficiary Information, is included with Form IL-1041. Schedule D is the required form for identifying any person who was a beneficiary during the tax year.

Schedule D has been redesigned for tax years ending on or after December 31, 2014, to report certain items of income reported to your beneficiaries, and pass-through withholding payments made on behalf of your ***nonresident*** beneficiaries.

Amounts that would have been reported on behalf of a trust or estate's beneficiaries on Form IL-1000 must be reported on Schedule D since that form was eliminated for tax years ending on and after December 31, 2014.

Schedule K-1-T, Schedule(s) K-1-T(3) (or Schedule K-1-T(3)-FY), as applicable and all of Schedule D, Step 2 must be completed before completing Schedule D, Step 1.

> Note: Schedule(s) K-1-T(3) and K-1-T(3)-FY are new forms for tax years ending on and after December 31, 2014 and are explained in the Pass-through Withholding Calculation section.

The completed Schedule D will be used to support the amount reported on the IL-1041, Step 7, Line 50 Pass-through withholding payments you reported on behalf of your members.

To verify the beneficiaries' percentages, a copy of the will must be obtained. For a trust, a copy of the `trust instrument' must be obtained. (A trust instrument is the formal document which created the trust and contains the powers of the trustees and the rights of the beneficiaries.)

Effective with tax years ending on or after December 31, 1998, the Schedule D was revised, replacing the Schedules D & E.

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Effective with taxable years ending on or after 12/31/90, the flow-through computation on Schedule D was corrected. For years ending prior to that date, the computation was incorrect.

j) Subtractions and Credits

Below is a list of subtraction modifications and income tax credits (as of 2016) for which trusts and estates are entitled, along with the applicable statute and regulation.

(1) Schedule 1299-B Subtractions

- Dividends from River Edge Redevelopment Zones (IITA §203(c)(2)(M), 86 IAC § 100.2480)
- Dividends from High Impact Business within a Foreign Trade Zones (or sub-zones) (IITA § 203(c)(2)(0), 86 IAC § 100.2490)

Pass-through amounts applicable to each beneficiary are reported in Step 5 on Schedule K-1-T.

(2) Schedule 1299-D Income Tax Credits

- TECH-PREP Youth Vocational Programs Credit (IITA § 209)*
- Dependent Care Assistance Program Credit (IITA § 201, 86 IAC §100.2195)*
- Film Production Services Tax Credit (IITA § 213, 86 IAC § 100.2185)
- Enterprise Zone or River Edge Redevelopment Zone Investment Credit (IITA § 201(f); 86 IAC § 100.2110)*
  (The River Edge Redevelopment Zone Investment credit has expired for tax years beginning on or after July 12, 2016).
- High Impact Business Investment Credit (IITA § 201(h); 86 IAC § 100.2130)*
- Tax Credit for Affordable Housing Donations (IITA § 214; 86 IAC § 100.2190)

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- Economic Development for a Growing Economy (EDGE) Credit (IITA § 211; 86 IAC § 100.2198)

- Research and Development Credit (originally expired for tax years ending after December 31, 2015) (IITA § 201(k); 86 IAC § 100.2160) P/A 100-0022 retroactively restored the credit for tax years ending after December 31, 2015. A supplemental Schedule 1299-D (R&D) has been designed to allow the credit to be claimed for the 2016 tax year, if applicable.

- River Edge Redevelopment Zone Remediation Credit (IITA § 201(n))

- Ex-Felons Jobs Credit (IITA § 216)

- Veterans Jobs Credit (IITA § 217 & § 217.1)

- Student-Assistance Contribution Credit (IITA § 218; 86 IAC § 100.2193)

- Angel Investment Credit (IITA § 220, 86 IAC § 100.2171)

- New Markets Credit

- River Edge Historic Preservation Credit (IITA § 221)

- Live Theater Production Tax Credit (IITA § 222)

- Hospital Credit (IITA § 223)

- Historic Preservation Credit (IITA § 219)
  (Expired for tax years ending after December 31, 2015)

  All Income credits are distributable by partnerships and S corporations and require Schedule K-1-P to support distributive share amounts (except for those noted *). Credits do not flow through a trust or estate to the beneficiaries, even if all income of trust or estate flows through.

  Refer to Chapter 36 for more details regarding credits.

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If the fiduciary is a partner in a partnership or a shareholder in an S corporation, any deductions or credits reported on K-1-P are to be claimed on Schedule 1299-B or Schedule 1299-D.

k) IL-1041--Schedule E

This schedule is the beneficiaries' information relating to August 1, 1969 appreciation amounts. Columns 1, 2 and 3 apply to all beneficiaries. Column 4 applies only to nonresident beneficiaries. Corporate beneficiaries are not entitled to claim this subtraction.

Effective for tax years ending on and after December 31, 1998 the IL-1041, Schedule E was replaced with Schedule K-1-T.

l) Auditor's Report

The Auditor's report for the IL-1041 is Form EDA-26. Schedule D information should be included as an audit schedule.

Any change to the IL-1041 in audit that would affect the tax of a resident or nonresident beneficiary automatically requires an audit of the beneficiary. This would be subject to comment in the narrative report of all the related returns examined. The auditor will be responsible for making changes to every beneficiary's return, unless the fiduciary agrees to pay the tax by filing an IL-1000, if none were originally filed or an IL-1000-X amending previously filed forms (for tax years ending prior to December 31, 2014) or IL-1041 or IL-1041-X, as applicable (for tax years ending on or after December 31, 2014).

D. Pass-through Entity Withholding

All pass-through entities (PTEs), i.e. partnerships, S corporations and trusts, with Illinois sourced income, are ***required*** to make tax payments on behalf of their **nonresident** partners, shareholders and beneficiaries for tax years ending on or after December 31, 2008. This is referred to as "Pass-through Entity Withholding". This pass-through payment requirement was established by Public Act 95-233 and Public Act 95-707.

1. Pass-through Withholding Calculation

For Tax Years ending on or after December 31, 2014

Public Act 98-0478 amended IITA § 502 eliminating the option for filing composite returns for partnerships, S corporations, and trusts for tax years ending on or after December 31, 2014. The Public Act also amended IITA § 709.5 to require

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withholding for the share of the items of nonbusiness income of the partnership, Subchapter S corporation or trust that are always allocated to Illinois under Section 303 regardless of the commercial domicile or any other attribute of the beneficiary (e.g., rental income from property located in Illinois) and the net of any credits under Article 2 of the IITA that flow through the entity to the owner.

86 IAC §100.5100(c) Petition for Residents to be included in the filing of a composite return, does not apply to the new Pass-through Withholding Calculation requirements since the K-1-P(3), K-1-P(3)-FY and K-1-T(3), K-1-T(3)-FY are not composite returns.

Amounts to be paid on behalf of the nonresident partners, shareholders and beneficiaries are reported on Form IL-1065 Partnership Replacement Tax Return, Form IL-1120-ST Small Business Corporation Replacement Tax Return or Form IL-1041 Fiduciary Income and Replacement Tax Return. In addition, the amounts reported on these forms will be paid with those returns, or with Form IL-505-B Automatic Extension Payment. Voluntary payments are to be made using Form IL-516-I or Form IL-516-B, Pass-through Prepayment Vouchers.

Lloyd's plan of operation filers will now file on Form IL-1065 following instructions in 86 IAC § 100.5130. All underwriters (resident and nonresident) who are members of an insurance business organized under a Lloyd's plan of operation may be included on Form IL-1065. No credit is allowed to any underwriter for its share of tax paid on Form IL-1065.

a) Schedule(s) K-1-P(3) Pass-through Withholding Calculation for Nonresident Members

Effective for tax years ending on or after December 31, 2014, Schedule K-1-P(3) was developed to calculate the required tax a partnership or S corporation must report and pay on behalf of its Illinois **nonresident** partners or shareholders that receive business or nonbusiness income and have not provided you with Form IL-1000-E Certificate of Exemption for Pass-through Withholding Payments.

(2014 and 2016 Schedules K-1-P(3)-FY have been developed to assist fiscal filers in calculating the correct pass-through withholding tax for their nonresident members.)

- If your tax year ends ***on*** December 31, 2014, the 2014 Schedule K-1-P(3) must be used
- If your tax year ends ***after*** December 31, 2014, the 2014 Schedule K-1-P(3)-FY must be used.
- If your tax year ends ***on or before*** June 30, 2017, the 2016 Schedule K-1-P(3) must be used.

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- If your tax year ends ***on or after*** July 1, 2017, the 2016 Schedule K-1-P(3)-FY must be used.

These forms replace Form IL-1023-C and Form IL-1000, which were eliminated and cannot be used for tax years ending on or after December 31, 2014.

A separate Schedule K-1-P(3) or K-1-P(3)-FY must be completed for each nonresident member who has not submitted a Form IL-1000-E.

Partnerships and S corporations issuing Schedule(s) K-1-P(3) or K-1-P(3)-FY are not to attach the schedules to their Form IL-1065 or Form IL-1120-ST. However, they must keep a copy of each schedule available for inspection by the Department, if requested. The K-1-P(3) or K-1-P(3)-FY is not sent to the partners or shareholders. Amounts calculated on these forms are reported to the partners or shareholders on the K-1-P the partnership or S corporation prepares.

Amounts calculated on the Schedule(s) K-1-P(3) or K-1-P(3)-FY are reported as follows:

From K-1-P(3) or K-1-P(3)-FY	To Schedule B (IL-1065 or IL-1120-ST)	To Members K-1-P
Step 3, Line 12	Step 2, Column G	
Step 3, Lines 13 and 16	Step 2, Column H	
Step 3, Lines 14 and 17	Step 2, Column I	
Step 3, Line 19	Step 2, Column J	Step 7, Line 54

IITA § 502(f-5) PAYMENT OF OWNER LIABILITIES BY PASS-THROUGHS

Per IITA 502(f-5) the Department is allowed to make rules to let the partnership or S-corporation report changes in liability or claim refunds on behalf of its partners or shareholders.

The S-corporation or partnership MUST agree to the entity changes and pay the tax on behalf of the entity and the partners/shareholders in order for IITA § 502(f-5) to apply.

For tax years ending on and after December 31, 2014, if the taxpayer (partnership or S-corporation) is agreeing to the audit changes, changes will be made to the Schedule B for ALL partners (non-resident and resident alike).

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Changes to the Schedule B will reflect:

- Column E - changes to the income/loss distributable to each partner/shareholder
- Column F – change this column to blank for any partner/shareholder that wasn't included in withholding originally
- Column G – report corrected share of Illinois income subject to pass-through withholding from K-1-P(3)
- Column H – report corrected pass-through withholding before credits from K-1-P(3)
- Column I – report corrected distributable share of credits from K-1-P(3)
- Column J – report correct amount of pass-through withholding payment amount reported on K-1-P. Changes to the pass-through payment attributable to the non-resident partners and resident partners will now show a pass-through payment attributable to the audit income change amount

The changes to the pass-through payment will flow to the IL-1065/IL-1120-ST pass-through payment line and the Column B change should show a change in pass-through payments

b) Schedule(s) K-1-T(3) Pass-through Withholding Calculation for Nonresident Members

Effective for tax years ending on or after December 31, 2014, Schedule K-1-T(3) was developed to calculate the required tax a trust or estate must report and pay on behalf of its Illinois **nonresident** beneficiaries that receive business or nonbusiness income and have not provided you with Form IL-1000-E Certificate of Exemption for Pass-through Withholding Payments.

(2014 and 2016 Schedule K-1-T(3)-FY have been developed to assist fiscal filers in calculating the correct pass-through withholding tax for their nonresident members.)

- If your tax year ends ***on*** December 31, 2014, the 2014 Schedule K-1-T(3) must be used
- If your tax year ends ***after*** December 31, 2014, only the 2014 Schedule K-1-T(3)-FY (for Fiscal Filers) must be used.
- If your tax year ends ***on or before*** June 30, 2017, the 2016 Schedule K-1-T(3) must be used.
- If your tax year ends ***on or after*** July 1, 2017, only the 2016 Schedule K-1-T(3)-FY (for Certain Fiscal Filers) must be used.

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These forms replace Form IL-1000, which was eliminated and cannot be used for tax years ending on or after December 31, 2014.

A separate Schedule K-1-T(3) or K-1-T(3)-FY must be completed for each nonresident member who has not submitted a Form IL-1000-E.

Estates and trusts issuing Schedule(s) K-1-T(3) or K-1-T(3)-FY are not to attach the schedules to their Form IL-1041. However, they must keep a copy of each schedule available for inspection by the Department, if requested. The K-1-T(3) or K-1-T(3)-FY is not sent to the beneficiaries. Amounts calculated on these forms are reported to the beneficiaries on the K-1-T the estate or trust prepares.

Amounts calculated on the Schedule(s) K-1-T(3) or K-1-T(3)-FY are reported as follows:

From K-1-T(3) or K-1-T(3)-FY	To Schedule D (IL-1041)	To Members K-1-T
Step 3, Line 12	Step 2, Column F	
Step 3, Line 13	Step 2, Column G	Step 7, Line 54

2. Pass-through Entity (PTE) Payments and Composite Income & Replacement Tax Returns

For Tax Years ending prior to December 31, 2014

Form IL-1000, Pass-through Entity Payment Income Tax Return, or Form IL-1023-C, Composite Income and Replacement Tax Return was filed by the PTE to report and pay withholding tax on behalf of its nonresident (and in some cases, resident) members. The PTE may elect to file either the IL-1000, the IL-1023-C or, in some cases, both. This will be contingent on the composition of their owners/members.

The ownership of the PTE can be comprised of resident and nonresident partners, shareholders or beneficiaries. The filing requirements for the PTE are different depending on the residency status of those owners:

Resident owner (shareholder/partner/beneficiary) filing:
The PTE provides the owners with a Schedule K-1-P or K-1-T for use in preparation of their Illinois return. PTEs cannot file an IL-1000 return or make a pass-through payment on behalf of Illinois residents.

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The PTE may petition the Department, and the Department may grant approval, to include a member who is an Illinois resident in the filing of a Composite Return under the following circumstance:

Clear demonstration that no other method of filing would achieve the same degree of compliance and administrative ease for the Department and the taxpayers. (86 IAC § 100.5100(c)). This requirement does not apply to a Lloyd's plan of operation.

Nonresident owner (shareholder/partner/beneficiary) filing:
The PTE provides the owners with a Schedule K-1-P or K-1-T. The schedule should reflect the amount of PTE payment made on their behalf. The nonresident owners who file an Illinois tax return to report the income are allowed to take the PTE credit to offset their tax liability.

Exemption for the IL-1000 filer:

Form IL-1000-E, Certificate of Exemption for Pass-through Entity Payments, would be completed by the owners that elect to make their own tax payments and assume the tax responsibility for themselves under the IITA. Once the certificate is received by the PTE, the entity is relieved of that portion of the PTE payment. The 1000-E must be submitted to the PTE prior to the due date of the IL-1000. The PTE should retain the certificates, and not send them to the Department unless specifically requested. Once accepted by the PTE, this Certificate of Exemption remains active unless the Department revokes the certificate or the non-resident owner requests the exemption be revoked. NOTE: The IL-1000-E is NOT available for use by nonresident "individual" owners.

Estates: Form IL-1000 is not required to be filed by estates. However, estates can file an IL-1000, if they so choose, on behalf of their beneficiaries.

Pertaining to the filing of Form IL-1023-C, all members not included on Form IL-1023-C are required to meet their Illinois filing obligations independently. Ref: 86 IAC Section 100.5120. If sufficient tax is paid on behalf of an owner on one or more Forms IL-1000 to cover that owner's Illinois tax liability, no return is required. Ref: IITA Section 502(a).

No estimated payments are required under 86 IAC § 100.5140; so no ES Late Payment penalty can be assessed for failure to make estimated payments. However, the taxpayer may make estimated payments using Form IL-1023-CES. In addition, if the taxpayer cannot file its IL-1023-C on or before the 15th day of the 4th month following the close of the agent's tax year, then Form IL-505-B must be filed along with payment.

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a) Net Operating Losses – Composite Returns

The regulations developed by the Department do not provide for a carryover or carryback of net operating losses on composite returns. The premise of the composite return is that it allows the tax that would have been reported by a number of separate entities to be reported on one return. It is not a return of the partnership, Subchapter S corporation or Lloyd's but rather is in respect of the individuals. Since there is no provision in the IITA for individuals to carry Illinois losses against Illinois income (rather than an adjusted gross loss at the federal level against adjusted gross income) there is no corresponding composite return provision. REF: SUNSHINE LETTER IT 88-0018.

b) Authorized Agents

In the case of composite returns, the partnership, Subchapter S corporation or the Lloyd's plan of operation is considered the authorized agent of the partners, shareholders, etc. included in the returns. As such, the authorized agent is responsible for the filing and amending of the returns, requests for extensions of the time to file, payment of the liabilities, responding to notices from the Department, filing of petitions (as explained below) and participation in any audits of the returns.

The composite returns must be signed by one of the following individuals:

1. In the case of a partnership, a general partner.

2. In the case of an S corporation, a corporate officer.

3. In the case of a Lloyd's plan of operation, an attorney-in-fact.

   An attorney-in-fact is an agent authorized by another to act in the principal's place, either for some particular purpose or for the transaction of business in general. For auditing purposes this authority would be conveyed through the execution of an IL-2848, Power-of-Attorney.

c) Flow-Through Payments

86 IAC § 100.5100(e) states:

> Nonresident individuals, trusts and estates with Illinois source income other than from a partnership, subchapter S corporation, or Lloyd's plan of operation may, but need not, be included in a composite return. If such nonresidents are included in a composite return for a taxable year ending on or after December 31, 2008

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(December 31, 1999, in the case of a composite return filed by a Lloyd's plan of operation), they may claim a credit against their Illinois income tax liability for their share of the tax paid on their behalf on the composite return. If nonresidents are included in a composite return for an earlier taxable year, they will not be permitted to claim credits on their individual returns for their shares of the composite tax payments unless the authorized agent files a petition with the Department of Revenue requesting permission for the nonresidents to claim the credit and the petition is granted.

The permission is obtained in the same manner for the inclusion of Illinois residents in a composite return.

The purpose of the petition is to allow the member to claim a credit for taxes paid on the composite return on the member's own return. Accordingly, NO PETITION IS REQUIRED IF:

1. ALL OF THE MEMBERS OF THE COMPOSITE RETURN ARE NONRESIDENTS OF ILLINOIS WITH NO OTHER ILLINOIS SOURCE INCOME; OR

2. THE MEMBERS WITH OTHER ILLINOIS SOURCE INCOME DO NOT WISH TO CLAIM THEIR PORTION OF THE COMPOSITE TAX PAYMENTS ON THEIR INDIVIDUAL RETURNS.

Any member of the group that is an Illinois resident or is a nonresident with Illinois income from other sources, so that his or her liability is not covered by a composite return or pass-through withholding, must file individual returns (IL-1040s, IL-1041s) in accordance with 86 IAC § 100.5160. The return should report ALL ILLINOIS INCOME including the person's share of the income that is reported on the composite tax return. A credit may then be claimed for the person's share of the composite tax payments and used to offset the individual Illinois tax liability. The credit is computed by multiplying the composite tax payments made by a fraction, the numerator of which is the individual's proportionate share of the composite tax liability and the denominator of which is the total composite tax liability.

A composite return DOES NOT HAVE to include all members who are eligible to be included. Persons who are not included are responsible for filing their own Illinois returns and paying their individual tax liabilities. Also, with the exception of the petitions discussed above, the authorized agent of the composite return does not have to notify the Department of the decision to cease filing the composite return or of any change in the membership of the return for the subsequent years.

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Example: The Acme partnership consists of a general partner and 50 limited partners. The general partner is a regular corporation, and the limited partners consist of 26 nonresident individuals, 20 resident individuals, a S corporation, a partnership, a nonresident estate, and a nonresident trust. The 26 nonresident individuals, the nonresident estate, and the nonresident trust may be included on Form IL-1023-C. The 20 resident individuals **may** be included if Acme submits a petition and the Department grants approval. None of the other partners may be included.

d) Business Income Versus Nonbusiness Income

Form IL-1000 (for tax years ending before December 31, 2014) is used to report and pay the required tax on behalf of nonresident owners that receive business income from the PTE. Confusion exists regarding nonbusiness income that the nonresident owners may receive.

- If the nonresident owners have only business income, the PTE is required to file the IL-1000 to report and pay the tax liability on the owner's behalf.
- If the nonresident owners have only nonbusiness income, the PTE is not required to submit/pay the IL-1000 on the owner's behalf.
- If the nonresident owners have both business and nonbusiness income, the "recommended" solution is for the owners (if not an individual) to complete the IL-1000-E and submit it to the PTE, and then report (file) and pay their own liability for both types of income. However, unless an IL-1000-E is received, the liability for the withholding on the business income portion remains with the PTE.

e) Confidentiality Issues

IITA § 917(a) prohibits disclosure of data received by the Department unless it is for official purposes including the collection of any state tax. Disclosing the results of a pass-through entity's audit, Action Decision, or other pertinent information related to the owner(s) of a pass-through entity is permissible under the law as long as the disclosure is pertinent to the owner's tax consequence. The "official purposes" exception would apply even if there is no audit on the pass-through entity, if the information is required for the owner(s) to establish their tax liability.

Example: During an audit of a partnership, adjustments were made that resulted in an increase to the flow-through income to the partners. If the partnership agrees with the audit results and elects to pay the partners' tax deficiencies [under IITA § 502(f-5)] it would not be necessary for the Department to notify the partners. The appropriate PTE return (IL-1000-X or IL-1023-C-X (for tax years ending before December 31, 2014) IL-1065-X (for

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tax years ending on and after December 31, 2014)) would be filed and paid for the partner's deficiencies. In this case, the partnership would obtain the rights to ICB.

However, if the partnership does not pay the deficiencies, the Department would notify the partners, which is allowed under IITA § 917(a), as to the audit results that caused these flow through deficiencies. Since the partners would then be responsible for these deficiencies, they would obtain the rights to ICB, not the partnership.

Note: For purposes of imposing the late payment penalty under UPIA Section 3-3(b-20)(2) at the 15% or 20% rates that apply after the initiation of an audit, the issuance of the Notice of Audit Initiation for a partnership, S corporation, or trust constitutes the initiation of an audit on the owners/beneficiaries as to the changes that flow through from the PTE return to the owners'/beneficiaries' returns.

f) Form IL-872, Consent to Extend the Time to Assess or Refund Income Tax

The IL-872 allows for a statute extension for issuance of a notice of deficiency (NOD) to the PTE for any applicable tax liabilities.

IITA § 905 applies to all taxes arising under the Illinois Income Tax Act, which would include IIT, BIT, WIT and pass-through entity withholding. An extension of the statute of limitations (under Section 905) should apply to all tax types.

When performing an IL-1000 audit, it is important to monitor the statute extension date on the IL-872 signed by the taxpayer, since there is no statutory extension to file Form IL-1000. The auditor must ensure that the statute on the IL-1000 does not expire before obtaining an IL-872.

Example: An IL-1120-ST audit is being performed for TY 12/10. The natural statute date for this audit is 10/15/2014. For the TY 12/10 IL-1000, the natural statute date is 3/15/2014. If changes will be made to the S corporation that will affect the IL-1000, then an IL-872 must be obtained that extends the statute past the IL-1000's natural statute. This will ensure any changes made to the IL-1120-ST can also be applied to the IL-1000, if applicable.

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g) Differences Between the IL-1000 and IL-1023-C

	IL-1000	IL-1023-C
Proper use of form – Who can be included on the form	Used for nonresident partners, shareholders, and beneficiaries who are not included on Form IL-1023-C or nonresident owners who did not provide an IL-1000-E	Generally used for nonresident individual, trust, or estate members with no other Illinois income other than the income reported on the IL-1023-C
Who cannot be included on the form	✓ Illinois residents ✓ Owners included on an IL-1023-C ✓ Owners that provided an IL-1000-E ✓ Exempt organizations	✓ Illinois residents (except those approved by petition) ✓ Partnerships ✓ S corps ✓ C corps
Due Dates	By original due date of the entity return - for S Corp - 15th day of 3rd month for Partnerships/Fiduciaries - 15th day of 4th month	Due on/before 15th day of 4th month following close of the tax year
Extensions	None	Automatic 6 month extension to file
Credits – pass-through (not the payment credit)	Credits cannot be claimed	Credits can be claimed as reported on the IL-477 and Schedule 1299-A (for taxable years ending on or after December 31, 2009. 86 IAC §100.5150)
Overpayments on return	PTE cannot claim refund	PTE can claim refund
Reportable transactions (ATAT)	Does not fulfill the reporting obligation of the owners	Fulfills the reporting obligation of the members (owners)

Note: There are differences in the due dates for the IL-1000 and IL-1023-C. Penalty and interest will be calculated based on the appropriate due date.

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h) Nonresident Owner Requirements

All Illinois nonresidents have an Illinois tax obligation if they receive Illinois-sourced income.

If the PTE payment made on the nonresident owner's behalf covers their Illinois income tax obligation, the nonresident is not required to file an Illinois tax return. The nonresident owner who does file an Illinois tax return must report the income and is allowed to take credit for the PTE payment made on behalf of that owner.

The Schedule K-1-P issued to the nonresident partners, shareholders or beneficiaries should reflect the PTE payment made on their behalf. The nonresidents are ***required*** to attach the Schedule K-1-P or Schedule K-1-T to their return (**if they file**) in order to be given the applicable PTE credit against their liability. This credit will show as a "K1 credit" or a "credit for PTE" on the nonresidents' account in GenTax as shown below.

REQUIREMENTS FOR THE NONRESIDENT OWNER WHO IS ALSO A PASS-THROUGH ENTITY (TIERED ENTITY)

PTEs that are owners of a PTE with Illinois business income must file Form IL-1023-C or file Form IL-1000 (for tax years ending before December 30, 2014) or IL-1065, IL-1120-ST or IL-1041 (for tax years ending on or after December 30,2014), and make a PTE payment for their nonresident owners on the Illinois business income passed through to them, as well as on any Illinois business income they earn directly. For tax year ending on or after December 30, 2014 a PTE payment will also be required from nonresident owners on the share of nonbusiness income of the partnership, S-corporation or trust that is allocable to Illinois. Ref: 86 IAC Section 100.7035(a). In addition to receiving Schedule(s) K-1-P or K-1-T, the tiered entity must also issue Schedule(s) K-1-P or K-1-T to its owners.

Tiered entities that elect not to file Form IL-1000-E, Certificate of Exemption for Pass-through Entity Payments, will have a PTE payment made on their behalf. This payment can be used by the tiered entity as a credit on the Form IL-1000 or Form IL-1023-C (for tax years ending prior to December 31, 2014) or Forms IL-1065, IL-1120-ST or IL-1041 (for tax year ending on and after December 31,

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2014) that the entity files for its owners or as a credit on the annual tax return that is filed by the tiered entity.

When auditing a tiered entity, the auditor is responsible for each tier. The auditor must verify that the PTE has properly withheld and paid the tax liability for the owners at each level.

Example 1: (Partnership A and B are not unitary)
For tax year **2008**, Partnership A (a pass-through entity) has business income of $1,000 and an Illinois apportionment factor of 40 percent, for a total Illinois-sourced income of $400. It has two equal partners:

- Individual A, an Indiana resident

- Partnership B, a partnership (pass-through entity) doing business only in Indiana. Partnership B has not submitted an IL-1000-E. It has two equal partners, both individual residents of Ohio.

Partnership A must file an IL-1000 and make a total pass-through entity payment of $9.00:
$200 times 3 percent = $6 distributable to Individual A
$200 times 1.5 percent = $3 distributable to Partnership B

Partnership B must file an IL-1000 and make $6 in pass-through entity payments on the $200 of Illinois business income that passed through to it from Partnership A:
$100 times 3 percent = $3 distributable to Individual Ohio resident A, and
$100 times 3 percent = $3 distributable to Individual Ohio resident B

Partnership B must also file an IL-1065 and pay replacement tax on the $200.

NOTE: It may claim a credit for the $3 of pass-through entity payments made on its behalf on its Form IL-1000 or Form IL-1065.

If Partnership B submits an IL-1000-E to Partnership A, Partnership A will not be required to make a pass-through entity payment on the $200 distributable to Partnership B. However, Partnership B will still be required to pay replacement tax and make pass-through entity payments on the $200 that has been passed-through from Partnership A.

Example 2: (Partnership A and B are unitary)
For tax year **2008**, Partnership A (a pass-through entity) has business income of $1,000, on sales of $10,000, including Illinois sales of $4,000. Accordingly, it has an Illinois apportionment factor of 40 percent, for a total Illinois-sourced income of $400. It has two equal partners:

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- Individual A, an Indiana resident

- Partnership B, a partnership (pass-through entity) doing business only in Indiana. It has business income of $500 on sales of $10,000, none of which are Illinois sales. Partnership B has not submitted an IL-1000-E. It has two equal partners, both individual residents of Ohio.

Partnership A and B are unitary in this example.

Partnership A must file an IL-1000 and make a total pass-through entity payment of $9.00, the same as Example 1.
$200 times 3 percent = $6 distributable to Individual A
$200 times 1.5 percent = $3 distributable to Partnership B

Partnership B must file an IL-1000 and make pass-through entity payments on its Illinois business income, computed as follows:
Business Income = $500 from its own activities plus its $500 share (50% of 1,000) of the business income of Partnership A, or $1,000;

Illinois sales of $2,000 (50% of $4,000) passed through from Partnership A; and $10,000 in everywhere sales from its own activities plus its $5,000 share (50% of $10,000) of the everywhere sales of Partnership A, for a total of $15,000. Partnership B's apportionment factor is therefore 13.3333%, and its Illinois business income is $133.

$67 times 3 percent = $2 distributable to individual Ohio resident A, and
$67 times 3 percent = $2 distributable to individual Ohio resident B

Partnership B must also file an IL-1065 and pay replacement tax on the $133.

NOTE: It may claim a credit for the $3 of pass-through entity payments made on its behalf on its Form IL-1000 or Form IL-1065.

If Partnership B submits an IL-1000-E to Partnership A, Partnership A will not be required to make a pass-through entity payment on the $200 distributable to Partnership B. However, Partnership B will still be required to pay replacement tax and make pass-through entity payments on the $133 in business income that it apportions to Illinois.

i) Filing an Amended Return

An amended return (Form IL-1000-X, Amended Pass-through Entity Payment Income Tax Return or Form IL-1023-C-X, Amended Composite Income and Replacement tax Return (for tax years ending prior to December 31, 2014) or IL-

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1065-X, IL-1120-ST-X or IL-1041-X (for tax years ending on or after December 31, 2014)) should be used by PTEs if they have previously filed a processable original return. Since refunds of tax to the PTE are not permitted on the IL-1000 return, Form IL-1000-X can only be used to report and pay an underpayment of tax due. However, Form IL-1023-C-X, IL-1065-X, IL-1120-ST-X and IL-1041-X can be used to file a claim for tax.

- In the event the amount paid by the PTE is less than the tax obligation for its nonresident owners/members, the PTE is relieved of its obligation to pay the difference if the owners/members have paid their liability. Therefore, no amended return would be required. Ref: IITA § 713 and 86 IAC § 100.7035(f)(1).

- If the PTE overpaid the tax on Form IL-1000, it cannot file an amended return to claim a refund. The owner(s) for whom it overpaid will be responsible for filing an annual Illinois tax return and claiming any overpayment that was made by the PTE. However, if the taxpayer has evidence that they made duplicate payments for the tax or have remitted the payment in error, they may be entitled to a refund. (See Issue 1 under Issues Encountered with the Form IL-1000).

j) Penalties and Interest

Late-Filing Penalty

For Form IL-1000, if a processable return is not filed by the original due date of the entity's tax return, this penalty is assessable. For Form IL-1023-C, if a processable return is not filed by the extended due date of the entity's return, this penalty is assessable.

Late-Payment Penalty

If the total tax liability is not paid by the original due date of the return, this penalty is assessable.

Bad Check Penalty

If the remittance submitted by the taxpayer is not honored by the financial institution, this penalty is assessable.

Interest

Interest is calculated on tax from the day after the original due date of the return through the date the tax is paid.

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Note: Per 86 IAC Section 100.7035(f)(1), the PTE is relieved of its obligation to pay any amount due with respect to an owner, if the owner has paid its liability under the IITA on the income from which withholding was required. However, the PTE is not relieved of any penalty or interest otherwise applicable with respect to its failure to timely pay the withholding.

k) Audit Procedures

Since 86 IAC Section 100.7035(a) requires all pass-through entities to withhold from nonresident owners [except for those exempted under 100.7035(g)], every effort should be made in an audit situation to collect the required payments from the PTE as opposed to the owners. Pursuing the payment at the entity level, when feasible, represents the most expedient solution of collection.
When auditing a PTE, the auditor is responsible for ensuring that the PTE has fulfilled the reporting/payment obligation for the nonresident owners (partners, shareholders, and beneficiaries) as outlined in Section 709.5 of the IITA.

The Auditor's Report for composite return audits is the EDA-127 IL-1023-C Auditor's Report. Any adjustments to a previously filed IL-1023-C are to be reported on the EDA-127 and IL-870 (for non-APT audits).

When auditing partnerships with nonfiling, nonresident partners, Subchapter S corporations with nonfiling, nonresident shareholders or a Lloyd's plan of operation involving nonfiling, nonresident individuals, it is not necessary to prepare an Auditor's Report for each individual involved IF the individuals (through the partnership, Subchapter S corporation or Lloyd's plan) agree to the liability and/or pay the tax due. In these cases, the auditor may accept a composite return.

However, a composite return may not be accepted in cases where the liability is unagreed. In these situations, all nonfiling, nonresidents are liable for their individual tax liability, including penalties, and a Notice of Deficiency must be sent to each.

To assist the PTE in fulfilling its reporting/payment obligation ***during audit***, IITA § 502(f) allows Illinois residents to be included in the filing of a composite return without Department approval.

IITA § 502(f) states:

> …For taxable years ending prior to December 31, 2014, the Department may by regulation also permit such composite returns to include the income tax owed by **Illinois residents** attributable to their income from partnerships, Subchapter S corporations, insurance businesses organized under a Lloyds

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plan of operation or limited liability companies that are treated as partnership under Section 1501(a)(16) of this act, in which case such Illinois residents will be permitted to claim credits on their individual returns for their shares of the composite tax payments….(emphasis added)

IITA § 502(f-5) states:

For taxable years ending on or after December 31, 2008, the Department may adopt rules to provide that, when a partnership or Subchapter S corporation has made an error in determining the amount of any item of income, deduction, addition, subtraction, or credit required to be reported on its return that affects the liability imposed under this Act on a partner or shareholder, the partnership or Subchapter S corporation may report the changes in liabilities of its partners or shareholders and claim a refund of the resulting overpayments, or pay the resulting underpayments, on behalf of its partners and shareholders.

Note: A separate audit track is required for the IL-1000 or IL-1023-C audit.

(1) Submitting an SC-137 Audit Referral/Request for IL-1023-C returns

For Audit Planning to make the proper determination as to what type of audit will be set up (IL-1023-C or IL-1000), the following information must be submitted with the request in the "Reason for Referral" section of the SC-137:

- Was the audit of the business income tax return agreed to?
- If so, will the business be submitting a payment for the resulting changes to the composite return?
- How many members will be included on the IL-1023-C?
- Are the members residents, nonresidents or both?
- Will the resulting changes to the composite return affect only credits?

(2) Verify Filing History:

Determine if Form IL-1000 or IL-1023-C was filed and payment made on behalf of the nonresident owners or members by researching GenTax.

(3) Verify Payment History:

"Assuming the payment is sufficient" is not procedurally correct when verifying filing and payment of the PTE returns.

Column F on Schedule B (IL-1065 and IL-1120-ST) and Schedule D (IL-1041) (for tax years ending before December 31, 2014) and Column J on Schedule B (IL-1065 and IL-1120-ST) and Column G on Schedule D (IL-1041) (for tax

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years ending on and after December 31, 2014) ***should*** be the amount of the PTE payment made on behalf of the nonresident owner. This amount ***should*** correspond to the figure reported to the owner on the Schedule K-1-P or Schedule K-1-T. HOWEVER, THIS INFORMATION HAS PROVEN TO BE VERY INCONSISTENT AND INACCURATE. Therefore, it is essential that the auditor determine the amount of tax liability for each nonresident owner and compare that to the amount reported and paid on the PTE return (IL-1000 or IL-1023-C (for tax years ending before December 31, 2014) IL-1065, IL-1120-ST or IL-1041 (for tax years ending on and after December 31, 2014)).

There have been instances where the taxpayer has made a prepayment using the incorrect voucher. If the taxpayer indicates that a payment has been made and it is not showing on the correct account (i.e. Pass-Through or Composite) research of the taxpayer's other accounts may be necessary.

(4) Review the Schedules K-1-P or K-1-T Issued by the PTE:

A) Copies of the Schedules K-1-P and K-1-T issued to the nonresident owners should be obtained. The figures for the IL-1000 should match the totals shown on these Schedules K-1-P or K-1-T. The PTE is required to keep a copy of these schedules and must supply them when requested. Although not required, some PTE filers will attach the K-1-Ps/K-1-Ts to their business/fiduciary return. As a last resort, the business/fiduciary return can be ordered from files.

B) The Schedules K-1-P and K-1-T should be reviewed for accuracy prior to using them to calculate any PTE requirement. In some cases, PTEs have misclassified business income as reported on their business return as nonbusiness income on the K-1-Ps and K-1-Ts.

C) Due to the fact that there is no extension for filing on the IL-1000, some PTEs may "estimate" the liability for their nonresident owners since the exact amount of flow-through income may not be known at the time the IL-1000 is due. This may cause differences between the amount of PTE withholding due and the amount of PTE withholding reported to the nonresident owners/members. If the PTE has underestimated its withholding obligation, it should file a Form IL-1000-X, reporting and paying the additional withholding due.

(5) Verification of Amounts Reported by PTE to Its Nonresident Owners:

It is required that taxpayers complete the applicable Schedule B or Schedule D and include it with their annual filing. The PTEs must provide separate owner

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information on these schedules that will allow the Department to verify PTE payment amounts. The amounts reported on these schedules ***should*** agree with the amounts reported on each nonresident owner's Schedule K-1-P or K-1-T. However, more often than not, this is not the case. The information reported on the Schedule B or Schedule D must be compared to the Schedules K-1-P or K-1-T prior to determination of tax liability.

Beginning with the 2008 tax year, information from the Schedule B (IL-1065 or IL-1120-ST) has been captured in GenTax. Beginning with the 2012 tax year, Schedule D (IL-1041) and Schedule BC (IL-1023-C) are captured in GenTax. This information can be useful in determining the PTE liability and in verifying PTE compliance.

See **Exhibit O** for Schedule B screen shot information.

See **Exhibit P** for the Form IL-1000 Reconciliation flow charts using the Schedule B or Schedule D filed by the taxpayer.

(6) Calculating the Pass-Through Entity Liability

a) Form IL-1000:

Note: The instructions for calculation of line 1 of the IL-1000 changed after the 2008 tax year. The correct way to calculate the total business income apportioned to Illinois can be found on the Form IL-1000 with a revision date of 12/09. However, under the Taxpayers' Bill of Rights, no additional tax and no penalty or interest can be imposed on a PTE that underpaid its obligation solely because it followed the instructions on the version of the Form IL-1000 that was current when it filed its return.

The required PTE payment for nonresident owners on the IL-1000 equals the sum of their share of the PTE's business income apportioned to Illinois, times the Illinois tax rate applicable to that owner.

The owner's share of business income apportioned to Illinois is figured as follows:

Partnerships and S Corporations:
From the Schedule K-1-P issued to the nonresident owner subject to withholding, add the amounts from Column B partner's or shareholder's share of business income (loss) plus any business items in Column B of those partner's or shareholder's share of Illinois additions and subtractions. See Step 2 of **Exhibit Q**

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Trusts:
From the Schedule K-1-T issued to the nonresident owner subject to withholding, add the amounts from Column B beneficiary's share of business income (loss) plus any business items in Column B of those beneficiaries' shares of Illinois additions and subtractions.

b) Form IL-1023-C:

The required PTE payment for those members included on the IL-1023-C is calculated based on figures from the entity's BIT/fiduciary return. (See the instructions for Form IL-1023-C and 86 IAC § 100.5130 for proper calculation)

The regulations on the computation of taxable income on the IL-1023-C are:

- 86 IAC § 100.5130(a)(2)(A) – Income from a partnership
- 86 IAC § 100.5130(a)(2)(B) – Income from an S Corporation.

The tax liability, estimated payment applicability, and any penalty or interest computations will be made on a composite basis. The following rules apply to composite returns:

Partnerships

For nonresident partners, the composite return income is computed beginning with the partnership's base income without regard to the addition modifications for:

- The portion of guaranteed payments to partners NOT included in the composite return.
- The amount of loss distributable to a partner subject to replacement tax.
- and without regard to the subtraction modifications for:
- Personal service income or reasonable allowance for compensation of partners.
- Share of income distributable to a partner subject to replacement tax.
- Schedule M subtractions for any amount of the federal domestic production activity or oil and gas depletion deductions that is not

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allowed on Form IL-1065 but may pass through to eligible partners. (See FY Bulletin 2006-07).

The partnership's adjusted base income is then apportioned and/or allocated to Illinois as prescribed by the IITA and, finally, multiplied by the percentage of the total distributive shares of partnership income belonging to the nonresident partners included in the composite return.

Subchapter S Corporations

For nonresident shareholders, the composite return income is computed beginning with the Subchapter S corporation's base income without regard to the addition modifications for:

- the amount of loss distributable to a shareholder subject to replacement tax

And without regard to the subtraction modifications for:

- Share of income distributable to a shareholder subject to replacement tax
- River Edge Redevelopment Zone Interest
- High Impact Business Interest
- Contribution subtraction from Schedule 1299-A. Contributions made to a designated zone organization to be used for an enterprise zone or river edge redevelopment zone project approved by the Department of Commerce and Economic Opportunity (DCEO).
- Schedule M subtractions for any amount of the federal domestic production activity or oil and gas depletion deductions that is not allowed on Form IL-1120-ST, but may pass through to eligible shareholders. (See FY Bulletin 2006-07). However, exclude any subtractions allowed for foreign dividend gross-up, Subpart F income, or foreign dividends received.

The S corporation's adjusted base income is then apportioned and/or allocated to Illinois in accordance with the IITA and, finally, is multiplied by the percentage of the total S corporation's income belonging to the nonresident shareholders included in the composite return.

The tax liability is computed based on the amount of composite income that is allocable or apportionable to Illinois and is not reduced by the Standard

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Exemption prescribed in IITA § 204(a).

Note: If the nonresidents have not taken a PTE credit, thereby paying all of the tax on their own, it is not necessary to obtain an IL-1000 or IL-1023-C return from the entity, at least on behalf of those taxpayers. There may still be a requirement for the IL-1000 for other nonresidents. Ref: 86 IAC § 100.7035(f)(1).

Regardless of the assumption of the liability by the authorized agent, the members of the composite return are still liable for any unpaid balance due attributable to them in their separate capacities.

1) UNDERPAYMENT OF REQUIRED WITHHOLDING:

   a) If the PTE return is underpaid; either by virtue of incorrect filing originally or due to audit changes made to their PTE return, the auditor must secure an amended return *of the same type*. (If taxpayer filed IL-1000 originally, auditor must secure an IL-1000-X for changes. If taxpayer filed IL-1023-C originally, auditor must secure an IL-1023-C-X for changes).
   b) The PTE is relieved of its obligation to pay any amount due with respect to an owner, if the owner has paid its liability under the IITA on the income from which withholding was required. In this situation, no amended return would be required. Ref: IITA § 713 and 86 IAC § 100.7035(f)(1)

(7) IL-1023-C Processing Documentation

The following procedures provide guidance to auditors on the proper documentation to be submitted for an audit of the Form IL-1023-C when there are changes to base income and/or income tax credits/replacement tax investment credits.

IAC § 100.5180 Composite Returns: Overpayments and Underpayments provide guidance for reporting changes on composite returns.

IAC § 100.5180(b) states:

> For taxable years ending on or after December 31, 2008, a partnership or subchapter S corporation may report the changes in liabilities of its partners or shareholders and pay the resulting underpayments, on behalf of its partners and shareholders, whether or not a composite return was filed for the taxable year or any specific partner or shareholder was included on that composite return. A partnership or subchapter S corporation may claim a refund or credit of any amount it paid on behalf of its partners or shareholders under Section 100.5100,

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subsection (a) or this subsection, but may not claim a refund or credit of any amount paid to the Department by a partner or shareholder.

This statute allows for the inclusion of resident employees on the Forms IL-1023-C or IL-1023-C-X for audit purposes.

For tax years ending **prior to December 31, 2009**, Form IL-1023-C did not allow for the reporting of income tax credits or the recapture of investment credits.

Effective for tax years ending **on or after December 31, 2009**, the partners' and shareholders' share of income tax credits from their Schedule(s) K-1-P may be claimed on Form IL-1023-C.

Effective for tax years ending **on or after December 31, 2010 and before December 31, 2014**, the partners' and shareholders' share of investment credit recapture from their Schedule(s) K-1-P or K-1-T must be included on Form IL-1023-C.

The EDA-127, IL-1023-C Auditor's Report, in CIT Programs, CIT Standalone, is in the process of being updated to reflect these changes. Once completed there will be four EDA-127s:

- For tax years ending prior to December 31, 2009 (no reporting of income tax credits or investment credit recapture). Lines "Audit change to income tax credits" were added to capture audit changes to income tax credits and replacement tax credits;
- For tax years ending on or after December 31, 2009 and prior to December 31, 2010 (reporting of income tax credits only). Lines "Income tax credits (Schedule 1299-A required) and Investment Credits (Form IL-477 required) were added to capture income tax credits and investment credits;
- For tax year ending on December 31, 2010, 3% income tax rate (reporting of income tax credits and investment credit recapture). Lines "Recapture of investment credits (Schedule 4255 required) were added to recapture income tax and replacement tax investment credits; and
- For tax years ending on and after December 31, 2011 and prior to December 31, 2014, 5% income tax rate (reporting of income tax credits and investment credit recapture). Lines "Recapture of investment credits (Schedule 4255 required) were added to recapture income tax and replacement tax investment credits.

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IL-1023-C Filer

IAC § 100.5180(a) states:

When an authorized agent has made an error in determining the amount of any item of income, deduction, addition, subtraction or credit reported on a composite return, the authorized agent ***shall file an amended return*** to correct the error and claim a refund or credit, or pay the liability, for any person included on the composite return. (emphasis added)

Use the following chart to assist in determining the proper documentation necessary for each particular audit scenario.

Audit Scenario							Procedure
	Base Income		RTIC		IT Credit		Prepare the following documents
	+	-	+	-	+	-	(+ is increase, - is decrease)
1	✓						EDA-127 or IL-1023-C-X
2		✓					Signed IL-1023-C-X
3	✓		✓				Claim: IL-1023-C-X Bal. Due: EDA-127 or IL-1023-C-X
4	✓			✓			EDA-127 or IL-1023-C-X
5		✓	✓				Signed IL-1023-C-X
6		✓		✓			Claim: IL-1023-C-X Bal. Due: EDA-127 or IL-1023-C-X
7	✓					✓	EDA-127 and IL-1023-C-X
8		✓				✓	Claim: IL-1023-C-X Bal. Due EDA-127 or IL-1023-C-X
9	✓				✓		Claim: IL-1023-C-X Bal. Due: EDA-127 or IL-1023-C-X
10		✓			✓		Signed IL-1023-C-X
11						✓	EDA-127 or IL-1023-C-X
12					✓		Signed IL-1023-C-X

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IL-1023-C Non-filer

IAC § 100.5180(b) states, in part:

For taxable years ending on or after December 31, 2008, a partnership or subchapter S corporation may report the changes in liabilities of its partners or shareholders and pay the resulting ***underpayments***, on behalf of its partners and shareholders, ***whether or not a composite return was filed for the taxable year*** or any specific partner or shareholder was included on that composite return. (emphasis added)

Changes resulting in an ***overpayment*** are claimed on the applicable member return (i.e. IL-1040-X or IL-1041-X).

Payments submitted to the department for any other type of tax or overpayments of tax from any other type of tax return **cannot** be transferred to Form IL-1023-CES or Form IL-1023-C to satisfy your composite tax payment requirements. [emphasis added]

As a result of the above restriction, overpayments and underpayments reported on the same IL-870 (for non-APT audits) can only be offset if the original amounts were reported on the same tax form.

Use the following chart to assist in determining the proper documentation necessary for each particular audit scenario.

Audit Scenario							Procedure
	Base Income		**RTIC**		**IT Credit**		**Prepare the following documents**
	+	**-**	**+**	**-**	**+**	**-**	**(+ is increase, - is decrease)**
1	✓						EDA-127
2		✓					Signed IL-1040-X or IL-1041-X or applicable member return
3	✓		✓				Claim: Signed IL-1040-X or IL-1041-X or applicable member return Bal. Due: EDA-127
4	✓			✓			EDA-127
5		✓	✓				Signed IL-1040-X or IL-1041-X or applicable member return
6		✓		✓			Claim: Signed IL-1040-X or IL-1041-X or applicable member return

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Audit Scenario							Procedure
7	✓					✓	>10 members: EDA-127 ≤10 member: EDA-24 and IL-1040-X or EDA-26 and IL-1041-X
8		✓				✓	Claim: Signed IL-1040-X or IL-1041-X or applicable member return Bal. Due: >10 members: EDA-127 ≤10 members: EDA-24 and IL-1040-X or EDA-26 and IL-1041-X
9	✓				✓		Claim: Signed IL-1040-X or IL-1041-X or applicable member return Bal. Due: >10 members: EDA-127 ≤10 members: EDA-24 and IL-1040-X or EDA-26 and IL-1041-X
10		✓			✓		Signed IL-1040-X or IL-1041-X or applicable member return
11						✓	>10 members: EDA-127 ≤10 members: EDA-24 and IL-1040-X or EDA-26 and IL-1041-X
12					✓		Signed IL-1040-X or IL-1041-X or applicable member return

I) Issues Encountered with the Form IL-1000

The following situations provide insight on the issues that have been encountered with the processing of the original Form IL-1000 and how they are being handled at this time.

Issue 1 – Overpayment on the Form IL-1000

The Form IL-1000 has an overpayment. If the IL-1000 is overpaid, a refund will be issued ONLY on accounts in which the taxpayer can prove that an incorrect payment was remitted. Examples of an incorrect payment would include the following:

- Payments intended for another State Agency,

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- IRS payments,
- Duplicate Return Correction Notice (RCN) payment,
- Duplicate bill payment,
- Duplicate Statement of Account payment, or
- an ***obvious*** duplicate return payment.

Example: Although an IL-1000 payment was remitted, the PTE failed to file the IL-1000 return. A letter was sent to the PTE informing the entity that Form IL-1000 was required to be filed. When the PTE filed the IL-1000, it sent a second payment along with the return. Both payment amounts were identical and matched the tax due amount on the IL-1000 return. Obviously, the second payment received was a duplicate payment. In such case, a refund of the second payment amount is warranted.

No refund will be issued for any overpayment due to self-assessed penalty and interest. GenTax is **not** set up to automatically deactivate any overpayment on the pass-through account. Therefore, it is ***essential*** that the auditor clearly indicate on the processing documents and in the "Letter of Comments" the nature of the overpayment and what should be done with the overpayment.

Issue 2 – Audit debatch is not programmed for the IL-1000

Normally, returns that inadvertently go through the Department's front-end processing will "debatch" and come up to Audits if there is an "audit in progress" indicator on the account. However, that is not occurring for the IL-1000 returns.

If a taxpayer indicates returns have sent in response to the audit, and they have not been received by the auditor, the auditor should review the taxpayer's account in GenTax to see if the returns and/or payments have been processed. If so, the auditor is still required to review the returns and/or payments for accuracy. Any adjustments to the returns should be reflected on a working paper and documented in the auditor's "Letter of Comments".

m) Potential Audit Issues

Since pass-through entities can file both the Form IL-1000 and the Form IL-1023-C, confusion over the proper filing of these forms (and payment/voucher) has created issues for both the taxpayer and the Department. This section will address these issues and the correct resolution for dealing with that particular issue, using an "Issue/Resolution" format.

In audits that involve either the IL-1000 or IL-1023-C, **verification of the PTE requirement must be done.** Assuming the payment is sufficient to satisfy the

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liability is not procedurally correct as addressed in the PTE and Composite Income and Replacement Tax Return, Audit Procedures section.

1) Issue: The PTE filed both forms, an IL-1000 and an IL-1023-C, but over-reported the income on the IL-1000 and overpaid that tax liability. The PTE assumed that any overpayment on the IL-1000 could be applied to the IL-1023-C, which presented the correct tax liability. The owners/members were properly reported on each form, with no owners/members appearing on both forms per information provided from the PTE.

   Although on the surface, it may appear that the IL-1000 and IL-1023-C are interchangeable, certain explicit language regarding each restricts the Department from flowing payments between the two. Included in the instructions to Form IL-1023-C is a note as follows:

   > Payments submitted to the department for any other type of tax or overpayments of tax from any other type of tax return **cannot** be transferred to Form IL-1023-CES or Form IL-1023-C to satisfy your composite tax payment requirements. [emphasis added]

   Resolution: Separate payments should have originally been made with each form. However, to remedy this issue:

   - Verification of the PTE requirement must be done to ensure that the proper amount of payment was submitted.
   - The PTE should file an IL-1023-C-X to zero out the original IL-1023-C.
   - The owners (partners, shareholders, and beneficiaries) would be issued revised Schedule K-1-P/K-1-Ts to reflect the amount paid on the IL-1000.
   - Since the overpayment on the IL-1000 cannot be claimed by the PTE, the owners would file original or amended returns (as applicable) to make claims for refunds on the overpaid amounts. Claims must be timely and within statute.

   See **Exhibit Q** for an example of this issue.

2) Issue: The PTE overpaid the IL-1000, and then filed the IL-1000-X in an attempt to claim the overpayment.

   Resolution: If tax is overpaid on Form IL-1000, the PTE cannot file an amended return to claim any overpayment. Form IL-1000-X is for increased deficiencies only.

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Included in the General Information section on the Form IL-1000-X Instructions is a 'special note' as follows:

Refunds cannot be claimed for any payments you [the PTE] made that were reported (or should have been reported) to your partners, shareholders, or beneficiaries as amounts paid on their behalf. The partners, shareholders, or beneficiaries must claim these amounts on their own tax returns and are entitled to a refund or credit for any overpayment.

- The owners (partners, shareholders, and beneficiaries) may require revised Schedule K-1-P/K-1-Ts be issued to reflect the amount paid on the IL-1000.
- The owners would file original or amended returns (as applicable) to make claims for refunds on the overpaid amounts. Claims must be timely and within statute.

3) Issue: The PTE filed both forms, IL-1000 and IL-1023-C, and included some of the same owners/members on both forms. Payment of the liability was made with each return.

   Resolution: Members that are listed on Schedule BC of the IL-1023-C should not be included on the IL-1000. Per the IL-1023-C instructions:

   You [the PTE] are required to file Form IL-1000 and make payments only if you have nonresident partners or shareholders who are not included on your Form IL-1023-C. Payments cannot be made on behalf of the same partner or shareholder for the same taxable year on both forms.

   - The pass-through entity is required to file an IL-1023-C-X to remove the duplicate owners and request a refund of the duplicate payment (if within statute).

4) Issue: IL-1000 audits with payments pending but no return is on file.

   Resolution: The auditor should attempt to obtain an original, signed IL-1000 return so that the pending payment can be applied to the liability. The following should be followed:

   - Initiate audit, informing the taxpayer of the pending payment and requesting that taxpayer provide a signed return

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- If no response, provide taxpayer with an Auditor's Report outlining the liability in a second mailing including a cover letter again referencing the pending payment which can only be applied to the account if a signed return is provided.
- If no response ***and the pending payment fully satisfies the liability***, no EDA-122 Notice of Proposed Deficiency will be issued because the taxpayer will not be granted Informal Conference Board (ICB) rights.
- If no response ***and the auditor determines the tax liability is greater than the pending payment,*** the EDA-122 will be issued. The EDA-122 attachment should include a notation of the pending payment.
- If no response, issue IL-870 (non-APT audits) or Auditor's Report (APT audits), with notation in comment section that the taxpayer has a pending payment that will be applied upon receipt of signed IL-870 or Auditor's Report.
- If no response, close audit.
- NOD will be issued.

5) Issue: IL-1000 audits with pending payments where the PTE has improperly paid on behalf of *resident* partners/shareholders/beneficiaries (owners).

   Resolution: The auditor must obtain an original IL-1000 so that the payment can be applied.

   - Initiate audit, informing the taxpayer (PTE) of the pending payment and requesting that taxpayer provide a signed return. For future filing periods, the **PTE should be informed that it does not have a PTE withholding filing requirement since owners are residents.**
   - PTE should be advised that the resident owners are required to file amended returns (or original returns if applicable) claiming the PTE amount which was made erroneously on their behalf. THOSE RETURNS SHOULD BE SENT DIRECTLY TO THE AUDITOR. ***IF the auditor receives the amended (original) returns from the resident owners, they will prepare an SC-137 for each owner requesting an audit to process the returns. These SC-137s should not be prepared until the returns have been received.***
   - The IL-1000 audit and any related audits for the resident owners should be kept together and labeled as "related audits".

6) Issue: IL-1000 audits with pending payments – where the IL-1000 account is overpaid - and **payments were late** (assuming a signed return is provided by the taxpayer).

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Resolution: The auditor must obtain an original IL-1000 so that the payment can be applied.

- If payments were not made timely, penalty and interest should be calculated. The PTE is responsible for timely payments. Therefore, the entity is also liable for penalty and interest on any payments which are not timely.
- If the tax liability on the signed return is less than the pending payments, the overpayment **will not** be refunded. Since the nonresident owners would have taken the full PTE amount reported on their Schedule K-1-P, and assuming that is the amount of pending payment, the overpayment on the account cannot be used to offset the PTE's applicable penalty and interest. If that were to happen, the tax liability collected would be reduced.

  Example: The nonresident owner received a Schedule K-1-P reflecting a PTE credit of $16,000. The owners took the full $16,000 PTE credit when filing their return. Assuming the tax liability was $16,000, the full liability has been collected (as paid by the PTE). The PTE pending payment is $16,000; and was late. However, when the IL-1000 is completed, the tax liability is only $10,000. On paper, the PTE is "overpaid" by $6,000. However, the full $16,000 was taken by the nonresident owners. To allow the overpayment to be applied to penalty and interest would reduce the amount of tax collected.

- The PTE will be billed for any applicable penalty and interest upon processing of audit.
- Penalty & Interest Section of Auditor's Comments should include reference to the overpayment so that Audit Perfection will know NOT to use the overpayment to offset penalty and interest.

7) Issue: The PTE (S corp) failed to file and pay the IL-1000, but the owner (shareholder) filed and paid an IL-1040 timely reporting the income from the S corp. Question as to who would be responsible for the penalty and interest on the unpaid IL-1000 liability.

   Resolution: Regarding underpayments, 86 IAC § 100.7035(f)(1) provides that even when the owners have paid their own liability, the pass-through entity is not relieved of any P & I applicable to failure to timely pay the withholding. The PTE would be liable for the penalty and interest determined for late payment.

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8) Issue: The PTE should have submitted an IL-1000-P with its pre-payment for the IL-1000, but accidently sent the IL-1023-C-V with its payment instead. Form IL-1000 was then filed timely without a payment attached since the pre-payment was made.

   Resolution: Since the Department has received MANY payments made with the incorrect voucher, the policy is to allow the payments to be transferred to the correct return. In this case, the payment should be transferred to the IL-1000 return.

9) Issue: The PTE (partnership) has nine partners (S-corp, four individuals and four trusts). The S-corp and all trusts reported they were subject to replacement tax and therefore their income was subtracted from the IL-1065. A compliance check was done and it was determined that between two and four of the nine partners, depending on the year, had not filed their entity type's tax return to capture the pass-through liability from the partnership. An IL-1000 audit was initiated to capture the share of pass-through income for these partners.

   The partnership sent in signed and paid IL-1000s for all audit years. The auditor made changes to each year, the largest of which was the addition of income from a trust which did not file IL-1041s for any years and was not included on the original IL-1000s. The partnership did not agree, stating that the trust's income is not required on the IL-1000 because the trust distributes 100% of the income to an individual who filed an IL-1040.

   The federal Form 1041s filed by the trust indicate that it is a simple trust with all income being distributed on Line 18 (income distribution deduction) of the federal form.

   Resolution: Simple trusts are not exempt from Illinois income and replacement taxes. Therefore, it was appropriate for the partnership to subtract the trust income on the IL-1065 as subject to replacement tax.

   However, because the trust was allowed the income distribution deduction, which resulted in zero federal taxable income, the calculation of Illinois base income begins with zero federal taxable income, resulting in the trust having zero Illinois tax liability.

   The trust beneficiaries, who are considered partners of the partnership, as nonresidents, are eligible to join in the filing of a composite return. The income of the individual partners would be included in the appropriate line of the IL-1000.

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V. EXHIBITS

A. Exhibit A - 2017 Form IL-1065 Separately Stated Items

(IITA § 203(e)(2)(H))

Attach your payment and Form IL-1065-V here.

Step 2: Figure your ordinary income or loss US 1065 Sch K (Whole dollars only)

1	Ordinary income or loss, or equivalent from federal Schedule K.	1	Line 1 .00
2	Net income or loss from all rental real estate activities.	2	Line 2 .00
3	Net income or loss from other rental activities.	3	Line 3c .00
4	Portfolio income or loss.	4	Line 5,6a,7,8,9a
5	Net IRC Section 1231 gain or loss.	5	Line 10 .00
6	All other items of income or loss that were not included in the computation of income or loss on Page 1 of U.S. Form 1065 or 1065-B. See instructions. Identify:	6	.00
7	Add Lines 1 through 6. This is your ordinary income or loss.	7	.00

Step 3: Figure your unmodified base income or loss

8	Charitable contributions.	8	Line 13a .00
9	Expense deduction under IRC Section 179.	9	Line 12 .00
10	Interest on investment indebtedness.	10	Line 13b .00
11	All other items of expense that were not deducted in the computation of ordinary income or loss on Page 1 of U.S. Form 1065 or 1065-B. See instructions. Identify:	11	.00
12	Add Lines 8 through 11.	12	.00
13	Subtract Line 12 from Line 7. This amount is your total unmodified base income or loss.	13	.00

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B. Exhibit B - 2017 Form IL-1065 Addition Modifications

Step 4: Figure your income or loss

14	Enter your unmodified base income or loss from Line 13.	**14**	203(e)(2)(H) .00
15	State, municipal, and other interest income excluded from Line 14.	**15**	203(d)(2)(A) .00
16	Illinois replacement tax deducted in arriving at Line 14.	**16**	203(d)(2)(B) .00
17	Illinois Special Depreciation addition. **Attach** Form IL-4562.	**17**	203(d)(2)(D-5)&(D-6)
18	Related-party expenses addition. **Attach** Schedule 80/20.		203(d)(2)(D-7),(D-8),(D-9)
19	Distributive share of additions. **Attach** Schedule(s) K-1-P or K-1-T.	**19**	.00
20	Guaranteed payments to partners from U.S. Form 1065 or 1065-B.	**20**	203(d)(2)(C) .00
21	The amount of loss distributable to a partner subject to replacement tax. **Attach** Schedule B.	**21**	203(d)(2)(I) .00
22	Other additions. **Attach** Illinois Schedule M (for businesses).	**22**	See Sch M .00
23	Add Lines 14 through 22. This amount is your income or loss.	**23**	.00

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C. Exhibit C - 2017 Schedule M Additions (IL-1065)

Step 2: Figure your additions

Enter the amount of

1	Capital gain taxed under IRC Section 852(b)(3).	1		.00
2	Notes, bonds, debentures, or obligations issued by the Governments of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands.	2	203(d)(2)(A)	.00
3	Lloyd's plan of operation loss if reported on your behalf on Form IL-1065 and included in your federal taxable income.	3	502(f)	.00
4	Business expense recapture.	4	203(e)(3)	.00
5	Any other state's income tax deducted from federal taxable income. **(Form IL-1041 filers only)**	5		.00
6	Capital loss to be carried forward. **(Form IL-1041 filers only)**	6		.00
7	Student-Assistance Contribution Credit taken on Schedule 1299-A or 1299-D.	7	218(a)	.00
8	Dividends paid by a captive REIT.	8		.00
9	Income attributable to domestic production activities under IRC Section 199.	9	203(d)(2)(D-11)	.00
10	Other additions - Identify each item. _____	10	203(d)(2)(D)	.00
11	**Total additions.** Add Lines 1 through 10. Enter the amount here and on your Form IL-1120, Line 8, Form IL-1120-ST, Line 21, Form IL-1065, Line 22 or Form IL-1041, Line 10. →	11		.00

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D. Exhibit D - 2017 Form IL-1065 Subtraction Modifications

Step 5: Figure your base income or loss

24	Interest income from U.S. Treasury or other exempt federal obligations.	24	203(d)(2)(G) .00		
25	August 1,1969, valuation limitation amount. **Attach** Schedule F.	25	203(d)(2)(E) .00		
26	Personal service income or reasonable allowance for compensation of partners.	26	203(d)(2)(H) .00		
27	Share of income distributable to a partner subject to replacement tax. **Attach** Schedule B.	27	203(d)(2)(I) .00		
28	River Edge Redevelopment Zone Dividend subtraction. **Attach** Schedule 1299-A.	28	203(d)(2)(K) .00		
29	High Impact Business Dividend subtraction. **Attach** Schedule 1299-A.	29	203(d)(2)(M) .00		
30	Illinois Special Depreciation subtraction. **Attach** Form IL-4562.	30	203(d)(2)(O),(P)		
31	Related-party expenses subtraction. **Attach** Schedule 80/20.	31	203(d)(2)(Q),(R),(S),(T)		
32	Distributive share of subtractions. **Attach** Schedule(s) K-1-P or K-1-T.	32	.00		
33	Other subtractions. **Attach** Schedule M (for businesses).	33	See Sch M .00		
34	Total subtractions. Add Lines 24 through 33.			34	.00
35	**Base income or loss.** Subtract Line 34 from Line 23.			35	.00

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E. Exhibit E - 2017 Schedule M Subtractions (IL-1065)

Step 3: Figure your subtractions

Enter the amount of

12	Exempt interest dividends paid by regulated investment companies (IRC Section 852(b)(5)).			12	.00
13	Notes, bonds, debentures, or obligations issued by the Governments of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands to the extent the amounts were required to be added back on Line 2.			13	203(d)(2)(G) .00
14	Lloyd's plan of operation income if reported on your behalf on Form IL-1065.			14	502(f) .00
15	Income for which you claimed a credit under IRC Section 1341.			15	203(d)(2)(N) .00
16	Expenses of federally tax-exempt income and federal credits. See instructions. Specify any amount relating to the following:				
	a Interest expenses relating to municipal income (IRC Section 291)	a	.00		
	b Interest and other expenses related to federally tax-exempt interest (IRC Section 265)	b	.00		
	c Bond premium amortization on federally tax-exempt bonds (IRC Section 171)	c	.00		
	d Expenses related to certain federal credits (IRC Section 280C)	d	.00		
	e Change in insurance company reserves (IRC Section 807 or 832)	e	.00		
	f Reduction in depreciation related to railroad maintenance credits (IRC Section 45G)	f	.00		
	g Gross income resulting from alternative energy credits (IRC Section 87)	g	.00		
17	Add Lines 16a through 16g.			17	203(d)(2)(J) .00
18	Add Lines 12 through 15 and Line 17. Enter the amount here and on Line 19.			18	.00

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Step 3: Continued

19	Enter the amount from Line 18.			19	.00
20	Interest on the following obligations of Illinois state and local government, only if included in Illinois income (see instructions). **Attach** a copy of the statement that identifies the payer and the amount of interest for each obligation.				
	a Illinois Housing Development Authority bonds and notes (except housing-related commercial facilities bonds and notes)	a	.00		
	b Illinois Development Finance Authority bonds, notes, and other obligations (venture fund and infrastructure bonds only)	b	.00		
	c Illinois Sports Facilities Authority bonds	c	.00		
	d Illinois Development Finance Authority bonds (only those issued under the Illinois Development Finance Authority Act, Sections 7.80 through 7.87)	d	.00		
	e Illinois Development Finance Authority bonds or Illinois Finance Authority bonds issued under the Asbestos Abatement Finance Act	e	.00		
	f Bonds issued by the Illinois Finance Authority under the Illinois Finance Authority Act	f	.00		
	g Southwestern Illinois Development Authority bonds	g	.00		
	h Illinois Power Agency bonds issued by the Illinois Finance Authority under Other Powers Article in the Illinois Finance Authority Act	h	.00		
	i Central Illinois Economic Development Authority bonds issued under the Central Illinois Economic Development Authority Act	i	.00		
	j Eastern Illinois Economic Development Authority bonds issued under the Eastern Illinois Economic Development Authority Act	j	.00		
	k Southeastern Illinois Economic Development Authority bonds issued under the Southeastern Illinois Economic Development Authority Act	k	.00		
	l Southern Illinois Economic Development Authority bonds issued under the Southern Illinois Economic Development Authority Act	l	.00		
	m Illinois Urban Development Authority bonds issued under the Illinois Urban Development Authority Act	m	.00		
	n Downstate Illinois Sports Facilities Authority bonds issued under the Downstate Illinois Sports Facilities Authority Act	n	.00		
	o Western Illinois Economic Development Authority bonds issued under the Western Illinois Economic Development Authority Bonds Act	o	.00		
	p Upper Illinois River Valley Development Authority bonds issued under the Upper Illinois River Valley Development Authority Act	p	.00		
	q Will-Kankakee Regional Development Authority bonds issued under the Will-Kankakee Regional Development Authority Law	q	.00		
	r Tri-County River Valley Development Authority bonds issued under the Tri-County River Valley Development Authority Law	r	.00		
	s Quad Cities Regional Economic Development Authority bonds and notes (if declared to be exempt from taxation by the Authority)	s	.00		
	t Quad Cities Interstate Metropolitan Authority bonds	t	.00		
	u Rural Bond Bank Act bonds and notes	u	.00		
	v Bonds issued under the Export Development Act of 1983	v	.00		
	w College savings bonds issued under the General Obligation Bond Act in accordance with the Baccalaureate Savings Act	w	.00		
21	Add Lines 20a through 20w.			21	203(d)(2)(G) .00
22	Add Lines 19 and 21.			22	.00

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Step 3: Continued

23	Enter the amount from Line 22.	23	.00
24	Federally taxed Illinois state refund from prior years.	24	203(d)(2)(F) .00
25	Dividends received, including IRC Section 78 Foreign Dividend Gross-up and subpart F income. **(Form IL-1120-ST filers only)**	25	.00
26	Contributions made to a job training project. See instructions. **(Form IL-1120-ST and Form IL-1065 filers only)**	26	203(d)(2)(L) .00
27	Reparations or other amounts received as a victim of persecution by Nazi Germany. **(Form IL-1041 filers only)**	27	.00
28	Income eligible for a deduction by an attorney-in-fact under IRC Section 835.	28	.00
29	Income from Illinois pre-need funeral, burial, and cemetery trusts.	29	203(d)(2)(G) .00
30	Income earned by nuclear decommissioning trusts established under the Public Utilities Act.	30	203(d)(2)(G) .00
31	Recovery of items previously deducted on Form U.S. 1040 Schedule A, filed by the decedent (including refunds of any state and local income taxes, other than Illinois). **(Form IL-1041, Estate filers only)**	31	.00
32	Refunds of state income taxes added back in a prior year on Schedule M, Line 5. **(Form IL-1041 filers only)**	32	.00
33	RESERVED	33	.00
34	Unused patronage or nonpatronage loss amounts from Schedule INL. **(Form IL-1120 filers only)** See instructions. Identify the year you first made the Schedule INL, Step 2, Line 1a election. _____	34	.00
35	Eligible subtractions from Publication 101 that are not subtracted anywhere else. See instructions. Identify each item. _____	35	203(d)(2)(G) .00
36	**Total subtractions.** Add Lines 23 through 35. Enter the amount here and on Form IL-1120, Line 21, Form IL-1120-ST, Line 33, Form IL-1065, Line 33, or Form IL-1041, Line 24. →	36	.00

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F. Exhibit F - 2017 Form IL-1120-ST Separately Stated Items

(IITA § 203(e)(2)(G))

Step 2: Figure your ordinary income or loss US 1120S Sch K (Whole dollars only)

Attach your payment and Form IL-1120-ST-V here.

1	Ordinary income or loss, or equivalent from federal Schedule K.	1	Line 1 .00
2	Net income or loss from all rental real estate activities.	2	Line 2 .00
3	Net income or loss from other rental activities.	3	Line 3c .00
4	Portfolio income or loss.	4	Line 4,5a,6,7,8a .00
5	Net IRC Section 1231 gain or loss.	5	.00
6	All other items of income or loss that were not included in the computation of income or loss on Page 1 of U.S. Form 1120-S. See instructions. Identify:	6	.00
7	Add Lines 1 through 6. This is your ordinary income or loss.	7	.00

Step 3: Figure your unmodified base income or loss

8	Charitable contributions.	8	Line 12a .00
9	Expense deduction under IRC Section 179.	9	Line 11 .00
10	Interest on investment indebtedness.	10	Line 12b .00
11	All other items of expense that were not deducted in the computation of ordinary income or loss on Page 1 of U.S. Form 1120-S. See instructions. Identify:	11	.00
12	Add Lines 8 through 11.	12	.00
13	Subtract Line 12 from Line 7. This amount is your total unmodified base income or loss.	13	.00

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G. Exhibit G - 2017 Form IL-1120-ST Addition Modifications

Step 4: Figure your income or loss

14	Enter the amount from Line 13. **Unitary filers**, enter the amount from Schedule UB, Step 2, Col E, Line 30.	14	203(e)(G) .00
15	State, municipal, and other interest income excluded from Line 14.	15	203(b)(2)(A) .00
16	Illinois replacement tax and surcharge deducted in arriving at Line 14.	16	203(b)(2)(B) .00
17	Illinois Special Depreciation addition. **Attach** Form IL-4562.	17	203(b)(2)(E-10)&(E-11) .00
18	Related-party expenses addition. **Attach** Schedule 80/20.	18	203(b)(2)(E-12)(E-13)&(E-14) .00
19	Distributive share of additions. **Attach** Schedule(s) K-1-P or K-1-T.	19	.00
20	The amount of loss distributable to a shareholder subject to replacement tax. **Attach** Schedule B.	20	203(b)(2)(S) .00
21	Other additions. **Attach** Illinois Schedule M (for businesses).	21	See Sch M .00
22	Add Lines 14 through 21. This amount is your income or loss.	22	.00

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H. Exhibit H - 2017 Schedule M Additions (IL-1120-ST)

Step 2: Figure your additions

Enter the amount of

1	Capital gain taxed under IRC Section 852(b)(3).	1	203(b)(2)(C) .00
2	Notes, bonds, debentures, or obligations issued by the Governments of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands.	2	203(b)(2)(A) .00
3	Lloyd's plan of operation loss if reported on your behalf on Form IL-1065 and included in your federal taxable income.	3	502(f) .00
4	Business expense recapture.	4	203(e)(3 .00
5	Any other state's income tax deducted from federal taxable income. **(Form IL-1041 filers only)**	5	.00
6	Capital loss to be carried forward. **(Form IL-1041 filers only)**	6	.00
7	Student-Assistance Contribution Credit taken on Schedule 1299-A or 1299-D.	7	203(b)(2)(E-16).00
8	Dividends paid by a captive REIT.	8	203(b)(2)(E-15).00
9	Income attributable to domestic production activities under IRC Section 199.	9	203(b)(2)(E-17).00
10	Other additions - Identify each item. _____	10	203(b)(2)(A)(E)(E-5).00
11	**Total additions.** Add Lines 1 through 10. Enter the amount here and on your Form IL-1120, Line 8, Form IL-1120-ST, Line 21, Form IL-1065, Line 22 or Form IL-1041, Line 10. →	11	.00

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I. Exhibit I - 2017 Form IL-1120-ST Subtraction Modifications

Step 5: Figure your base income or loss

23	Interest income from U.S. Treasury or other exempt federal obligations.	23	203(b)(2)(J) .00
24	Share of income distributable to a shareholder subject to replacement tax. **Attach** Schedule B.	24	203(b)(2)(S) .00
25	River Edge Redevelopment Zone Dividend subtraction. **Attach** Schedule 1299-A.	25	203(b)(2)(K) .00
26	River Edge Redevelopment Zone Interest subtraction. **Attach** Schedule 1299-A.	26	203(b)(2)(M) .00
27	High Impact Business Dividend subtraction. **Attach** Schedule 1299-A.	27	203(b)(2)(L) .00
28	High Impact Business Interest subtraction. **Attach** Schedule 1299-A.	28	203(b)(2)(M-1) .00
29	Contribution subtraction. **Attach** Schedule 1299-A.	29	203(b)(2)(N) .00
30	Illinois Special Depreciation subtraction. **Attach** Form IL-4562.	30	203(b)(2)(T)&(U) .00
31	Related-party expenses subtraction. **Attach** Schedule 80/20.	31	203(b)(2)(V)(W)(X)(Y) .00
32	Distributive share of subtractions. **Attach** Schedule(s) K-1-P or K-1-T.	32	See Sch M .00
33	Other subtractions. **Attach** Schedule M (for businesses).	33	.00

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J. Exhibit J - 2017 Schedule M Subtractions (IL-1120-ST)

Step 3: Figure your subtractions

Enter the amount of

12	Exempt interest dividends paid by regulated investment companies (IRC Section 852(b)(5)).	12	203(b)(2)(H .00
13	Notes, bonds, debentures, or obligations issued by the Governments of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands to the extent the amounts were required to be added back on Line 2.	13	203(b)(2)(J) .00
14	Lloyd's plan of operation income if reported on your behalf on Form IL-1065.	14	502(f) .00
15	Income for which you claimed a credit under IRC Section 1341.	15	203(b)(2)(Q) .00
16	Expenses of federally tax-exempt income and federal credits. See instructions. Specify any amount relating to the following:		
a	Interest expenses relating to municipal income (IRC Section 291)	a	.00
b	Interest and other expenses related to federally tax-exempt interest (IRC Section 265)	b	.00
c	Bond premium amortization on federally tax-exempt bonds (IRC Section 171)	c	.00
d	Expenses related to certain federal credits (IRC Section 280C)	d	.00
e	Change in insurance company reserves (IRC Section 807 or 832)	e	.00
f	Reduction in depreciation related to railroad maintenance credits (IRC Section 45G)	f	.00
g	Gross income resulting from alternative energy credits (IRC Section 87)	g	.00
17	Add Lines 16a through 16g.	17	203(b)(2)(I) .00
18	Add Lines 12 through 15 and Line 17. Enter the amount here and on Line 19.	18	.00

Step 3: Continued

19	Enter the amount from Line 18.	19	.00
20	Interest on the following obligations of Illinois state and local government, only if included in Illinois income (see instructions). **Attach** a copy of the statement that identifies the payer and the amount of interest for each obligation.		
a	Illinois Housing Development Authority bonds and notes (except housing-related commercial facilities bonds and notes)	a	.00
b	Illinois Development Finance Authority bonds, notes, and other obligations (venture fund and infrastructure bonds only)	b	.00
c	Illinois Sports Facilities Authority bonds	c	.00
d	Illinois Development Finance Authority bonds (only those issued under the Illinois Development Finance Authority Act, Sections 7.80 through 7.87)	d	.00
e	Illinois Development Finance Authority bonds or Illinois Finance Authority bonds issued under the Asbestos Abatement Finance Act	e	.00
f	Bonds issued by the Illinois Finance Authority under the Illinois Finance Authority Act	f	.00
g	Southwestern Illinois Development Authority bonds	g	.00
h	Illinois Power Agency bonds issued by the Illinois Finance Authority under Other Powers Article in the Illinois Finance Authority Act	h	.00

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l	Central Illinois Economic Development Authority bonds issued under the Central Illinois Economic Development Authority Act	l	_____.00		
j	Eastern Illinois Economic Development Authority bonds issued under the Eastern Illinois Economic Development Authority Act	j	_____.00		
k	Southeastern Illinois Economic Development Authority bonds issued under the Southeastern Illinois Economic Development Authority Act	k	_____.00		
l	Southern Illinois Economic Development Authority bonds issued under the Southern Illinois Economic Development Authority Act	l	_____.00		
m	Illinois Urban Development Authority bonds issued under the Illinois Urban Development Authority Act	m	_____.00		
n	Downstate Illinois Sports Facilities Authority bonds issued under the Downstate Illinois Sports Facilities Authority Act	n	_____.00		
o	Western Illinois Economic Development Authority bonds issued under the Western Illinois Economic Development Authority Bonds Act	o	_____.00		
p	Upper Illinois River Valley Development Authority bonds issued under the Upper Illinois River Valley Development Authority Act	p	_____.00		
q	Will-Kankakee Regional Development Authority bonds issued under the Will-Kankakee Regional Development Authority Law	q	_____.00		
r	Tri-County River Valley Development Authority bonds issued under the Tri-County River Valley Development Authority Law	r	_____.00		
s	Quad Cities Regional Economic Development Authority bonds and notes (if declared to be exempt from taxation by the Authority)	s	_____.00		
t	Quad Cities Interstate Metropolitan Authority bonds	t	_____.00		
u	Rural Bond Bank Act bonds and notes	u	_____.00		
v	Bonds issued under the Export Development Act of 1983	v	_____.00		
w	College savings bonds issued under the General Obligation Bond Act in accordance with the Baccalaureate Savings Act	w	_____.00		
21	Add Lines 20a through 20w.			21	203(b)(2)(J) .00
22	Add Lines 19 and 21.			22	_____.00

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Step 3: Continued

23	Enter the amount from Line 22.	23	.00
24	Federally taxed Illinois state refund from prior years.	24	203(b)(2)(F) .00
25	Dividends received, including IRC Section 78 Foreign Dividend Gross-up and subpart F income. **(Form IL-1120-ST filers only)**	25	203(b)(2)(G)(O)&(Z) .00
26	Contributions made to a job training project. See instructions. **(Form IL-1120-ST and Form IL-1065 filers only)**	26	203(b)(2)(P) .00
27	Reparations or other amounts received as a victim of persecution by Nazi Germany. **(Form IL-1041 filers only)**	27	.00
28	Income eligible for a deduction by an attorney-in-fact under IRC Section 835.	28	203(b)(2)(R) .00
29	Income from Illinois pre-need funeral, burial, and cemetery trusts.	29	203(b)(2)(J) .00
30	Income earned by nuclear decommissioning trusts established under the Public Utilities Act.	30	203(b)(2)(J) .00
31	Recovery of items previously deducted on Form U.S. 1040 Schedule A, filed by the decedent (including refunds of any state and local income taxes, other than Illinois). **(Form IL-1041, Estate filers only)**	31	.00
32	Refunds of state income taxes added back in a prior year on Schedule M, Line 5. **(Form IL-1041 filers only)**	32	.00
33	RESERVED	33	.00
34	Unused patronage or nonpatronage loss amounts from Schedule INL. **(Form IL-1120 filers only)** See instructions. Identify the year you first made the Schedule INL, Step 2, Line 1a election. _____	34	.00
35	Eligible subtractions from Publication 101 that are not subtracted anywhere else. See instructions. Identify each item. _____	35	203(b)(2)(J) .00
36	**Total subtractions.** Add Lines 23 through 35. Enter the amount here and on Form IL-1120, Line 21, Form IL-1120-ST, Line 33, Form IL-1065, Line 33, or Form IL-1041, Line 24. →	36	.00

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K. Exhibit K - 2017 Form IL-1041 Addition Modifications

IITA § 203(e)(1)

Step 2: Figure your income or loss

		A Beneficiaries (Whole dollars only)	B Fiduciary (Whole dollars only)
1	Federal taxable income from U.S. Form 1041, Line 22.		1 203(e)(1) .00
2	Federal net operating loss deduction from U.S. Form 1041, Line 15b. This amount cannot be negative.		2 203(c)(2)(D) .00
3	Taxable income of ESBT, if required. See instructions.		3 .00
4	Exemption claimed on U.S. Form 1041, Line 20.		4 203(c)(2)(B) .00
5	Illinois income and replacement tax and surcharge deducted in arriving at Line 1.	5a .00	5b 203(c)(2)(C) .00
6	State, municipal, and other interest income excluded from Line 1.	6a .00	6b 203(c)(2)(A) .00
7	Illinois Special Depreciation addition. **Attach** Form IL-4562.	7a .00	7b 203(c)(2)(G-10), (G-11)
8	Related-party expenses addition. **Attach** Schedule 80/20.	8a .00	203(c)(2)(G-12), (G-13), (G-14)
9	Distributive share of additions. **Attach** Schedule(s) K-1-P or K-1-T.	9a .00	9b .00
10	Other additions. **Attach** Illinois Schedule M (for businesses).	10a .00	10b See Sch M .00
11	Add Column B, Lines 1 through 10b. This amount is your income or loss. Report Column A, Lines 5a through 10a, on Schedule K-1-T, Step 5.		11 .00

▶ Attach your payment and Form IL-1041-V here ◀

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L. Exhibit L - 2017 Schedule M Additions (IL-1041)

Step 2: Figure your additions

Enter the amount of

1	Capital gain taxed under IRC Section 852(b)(3).	1	203(c)(2)(G) .00
2	Notes, bonds, debentures, or obligations issued by the Governments of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands.	2	203(c)(2)(A) .00
3	Lloyd's plan of operation loss if reported on your behalf on Form IL-1065 and included in your federal taxable income.	3	502(f) .00
4	Business expense recapture.	4	203(e)(3) .00
5	Any other state's income tax deducted from federal taxable income. **(Form IL-1041 filers only)**	5	203(c)(2)(F) .00
6	Capital loss to be carried forward. **(Form IL-1041 filers only)**	6	.00
7	Student-Assistance Contribution Credit taken on Schedule 1299-A or 1299-D.	7	203(c)(2)(G-15) .00
8	Dividends paid by a captive REIT.	8	.00
9	Income attributable to domestic production activities under IRC Section 199.	9	203(c)(2)(G-16) .00
10	Other additions - Identify each item. _____	10	203(c)(2)(E),(G-5) .00
11	**Total additions.** Add Lines 1 through 10. Enter the amount here and on your Form IL-1120, Line 8, Form IL-1120-ST, Line 21, Form IL-1065, Line 22 or Form IL-1041, Line 10. →	11	.00

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M. Exhibit M - 2017 Form IL-1041 Subtraction Modifications

Step 3: Figure your base income or loss

		A Beneficiaries		B Fiduciary
12	Enter the amount of your income or loss from Line 11.		12	.00
13	August 1, 1969, valuation limitation amount. **Attach** Schedule F.	13a .00	13b	203(c)(2)(I) .00
14	Payments from certain retirement plans. See instructions.	14a .00	14b	203(c)(2)(H) .00
15	Interest income from U.S. Treasury and other exempt federal obligations.	15a .00	15b	203(c)(2)(K) .00
16	Retirement payments to retired partners.	16a .00	16b	.00
17	River Edge Redevelopment Zone Dividend subtraction. **Attach** Schedule 1299-B.	17a .00	17b	203(c)(2)(M) .00
18	High Impact Business Dividend subtraction. **Attach** Schedule 1299-B.	18a .00	18b	203(c)(2)(O) .00
19	Contributions to certain job training projects. See instructions.	19a .00	19b	203(c)(2)(N) .00
20	Illinois Special Depreciation subtraction. **Attach** Form IL-4562.	20a .00	20b	203(c)(2)(R),(S)
21	Related-party expenses subtraction. **Attach** Schedule 80/20.	21a .00	21b	203(c)(2)(T),(U),(V),(Y)
22	Distributive share of subtractions. **Attach** Schedule(s) K-1-P or K-1-T.	22a .00	22b	.00
23	ESBT loss amount. See instructions.	23a	23b	.00
24	Other subtractions. **Attach** Illinois Schedule M (for businesses).	24a .00	24b	.00
25	Total subtractions. Add Column B, Lines 13b through 24b. Report Column A, Lines 13a through 24a, on Schedule K-1-T, Step 5.		25	.00
26	**Base income or loss.** Subtract Line 25 from Line 12.		26	.00

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N. Exhibit N - 2017 Schedule M Subtractions (IL-1041)

Step 3: Figure your subtractions

Enter the amount of

12	Exempt interest dividends paid by regulated investment companies (IRC Section 852(b)(5)).	12	.00
13	Notes, bonds, debentures, or obligations issued by the Governments of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the Virgin Islands to the extent the amounts were required to be added back on Line 2.	13	203(c)(2)(K) .00
14	Lloyd's plan of operation income if reported on your behalf on Form IL-1065.	14	502(f) .00
15	Income for which you claimed a credit under IRC Section 1341.	15	203(c)(2)(P) .00
16	Expenses of federally tax-exempt income and federal credits. See instructions. Specify any amount relating to the following:		
a	Interest expenses relating to municipal income (IRC Section 291)	a	.00
b	Interest and other expenses related to federally tax-exempt interest (IRC Section 265)	b	.00
c	Bond premium amortization on federally tax-exempt bonds (IRC Section 171)	c	.00
d	Expenses related to certain federal credits (IRC Section 280C)	d	.00
e	Change in insurance company reserves (IRC Section 807 or 832)	e	.00
f	Reduction in depreciation related to railroad maintenance credits (IRC Section 45G)	f	.00
g	Gross income resulting from alternative energy credits (IRC Section 87)	g	.00
17	Add Lines 16a through 16g.	17	203(c)(2)(L) .00
18	Add Lines 12 through 15 and Line 17. Enter the amount here and on Line 19.	18	.00

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Step 3: Continued

19	Enter the amount from Line 18.			19	.00
20	Interest on the following obligations of Illinois state and local government, only if included in Illinois income (see instructions). **Attach** a copy of the statement that identifies the payer and the amount of interest for each obligation.				
a	Illinois Housing Development Authority bonds and notes (except housing-related commercial facilities bonds and notes)	a	.00		
b	Illinois Development Finance Authority bonds, notes, and other obligations (venture fund and infrastructure bonds only)	b	.00		
c	Illinois Sports Facilities Authority bonds	c	.00		
d	Illinois Development Finance Authority bonds (only those issued under the Illinois Development Finance Authority Act, Sections 7.80 through 7.87)	d	.00		
e	Illinois Development Finance Authority bonds or Illinois Finance Authority bonds issued under the Asbestos Abatement Finance Act	e	.00		
f	Bonds issued by the Illinois Finance Authority under the Illinois Finance Authority Act	f	.00		
g	Southwestern Illinois Development Authority bonds	g	.00		
h	Illinois Power Agency bonds issued by the Illinois Finance Authority under Other Powers Article in the Illinois Finance Authority Act	h	.00		
i	Central Illinois Economic Development Authority bonds issued under the Central Illinois Economic Development Authority Act	i	.00		
j	Eastern Illinois Economic Development Authority bonds issued under the Eastern Illinois Economic Development Authority Act	j	.00		
k	Southeastern Illinois Economic Development Authority bonds issued under the Southeastern Illinois Economic Development Authority Act	k	.00		
l	Southern Illinois Economic Development Authority bonds issued under the Southern Illinois Economic Development Authority Act	l	.00		
m	Illinois Urban Development Authority bonds issued under the Illinois Urban Development Authority Act	m	.00		
n	Downstate Illinois Sports Facilities Authority bonds issued under the Downstate Illinois Sports Facilities Authority Act	n	.00		
o	Western Illinois Economic Development Authority bonds issued under the Western Illinois Economic Development Authority Bonds Act	o	.00		
p	Upper Illinois River Valley Development Authority bonds issued under the Upper Illinois River Valley Development Authority Act	p	.00		
q	Will-Kankakee Regional Development Authority bonds issued under the Will-Kankakee Regional Development Authority Law	q	.00		
r	Tri-County River Valley Development Authority bonds issued under the Tri-County River Valley Development Authority Law	r	.00		
s	Quad Cities Regional Economic Development Authority bonds and notes (if declared to be exempt from taxation by the Authority)	s	.00		
t	Quad Cities Interstate Metropolitan Authority bonds	t	.00		
u	Rural Bond Bank Act bonds and notes	u	.00		
v	Bonds issued under the Export Development Act of 1983	v	.00	203(c)(2)(A)	
w	College savings bonds issued under the General Obligation Bond Act in accordance with the Baccalaureate Savings Act	w	.00		
21	Add Lines 20a through 20w.			21	.00
22	Add Lines 19 and 21.			22	.00

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Step 3: Continued

23	Enter the amount from Line 22.	23	.00
24	Federally taxed Illinois state refund from prior years.	24	203(c)(2)(J) .00
25	Dividends received, including IRC Section 78 Foreign Dividend Gross-up and subpart F income. **(Form IL-1120-ST filers only)**	25	.00
26	Contributions made to a job training project. See instructions. **(Form IL-1120-ST and Form IL-1065 filers only)**	26	.00
27	Reparations or other amounts received as a victim of persecution by Nazi Germany. **(Form IL-1041 filers only)**	27	203(c)(2)(Q) .00
28	Income eligible for a deduction by an attorney-in-fact under IRC Section 835.	28	.00
29	Income from Illinois pre-need funeral, burial, and cemetery trusts.	29	203(c)(2)(K) .00
30	Income earned by nuclear decommissioning trusts established under the Public Utilities Act.	30	203(c)(2)(K) .00
31	Recovery of items previously deducted on Form U.S. 1040 Schedule A, filed by the decedent (including refunds of any state and local income taxes, other than Illinois). **(Form IL-1041, Estate filers only)**	31	203(c)(2)(W) .00
32	Refunds of state income taxes added back in a prior year on Schedule M, Line 5. **(Form IL-1041 filers only)**	32	203(c)(2)(X) .00
33	RESERVED	33	.00
34	Unused patronage or nonpatronage loss amounts from Schedule INL. **(Form IL-1120 filers only)** See instructions. Identify the year you first made the Schedule INL, Step 2, Line 1a election. _____	34	.00
35	Eligible subtractions from Publication 101 that are not subtracted anywhere else. See instructions. Identify each item. _____	35	203(c)(2)(K) .00
36	**Total subtractions.** Add Lines 23 through 35. Enter the amount here and on Form IL-1120, Line 21, Form IL-1120-ST, Line 33, Form IL-1065, Line 33, or Form IL-1041, Line 24. →	36	.00

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O. Exhibit O - Examples – Schedule B Screen Shot Information

Example 1:
The screen shot of the Schedule B reflects a PTE payment of $120,548 made for the first nonresident owner.

[redacted]

The nonresident owner's transaction for the 2009 tax year indicates they took a PTE credit of $120,548 as reported to them on the Schedule K-1-P which they were issued.

[redacted]

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Example 2:
The screen shot of the Schedule B shows the first owner as receiving no PTE payment, due to being an IL resident. The second owner (nonresident) reflects a PTE payment of $126,416.

The nonresident owner's transaction for the 2011 tax year indicates they took a PTE credit of $184,628.

**This is a perfect example of a situation where the IL-1040 return for the owner should be ordered to review the PTE credits. Since the nonresident is required to attach the Schedules K-1-P, the documentation for the PTE credit is available. In this particular case, three spin-off audits were generated since the additional PTE credit taken was from other entities who had not filed the required IL-1000 returns. The nonresident will always be given credit for the PTE payment (assuming they attached the required Schedules K-1-P), since the obligation for payment lies with the pass-through entity, not the nonresident.

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Example 3:
This account has a pending payment of $29,467.

[redacted]

The Schedule B shows they reported PTE credits of approximately $126,660. The entity return should be ordered to see if they have attached the Schedules K-1-P they issued. This will help verify how much the PTE should have paid and/or credit that may have been taken. It is important to verify the liability on audits where we have pending payments. Do not just assume that the pending payment is the entire liability.

[redacted]

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P. Exhibit P - Form IL-1000 Reconciliation

Form IL-1000 Reconciliation Using Schedule B

Form IL-1000

Line 6

Line 6 is the total pass-through entity payment required to be remitted to the Department.

Schedule B

(This schedule is required for Form IL-1065 and Form IL-1120-ST)

Schedule B Columns

Column F

This column is where the pass-through entity lists the pass-through payment amount made for each of the partners/shareholders. The total of Column F should equal the amount reported on Line 6 of Form IL-1000.

Column G

This column is where the pass-through entity identifies those partners/shareholders excluded from pass-through entity payments.

Column G exclusion codes

R

Indicates that the partner or shareholder is an Illinois resident. No pass-through entity (PTE) withholding is **permitted.** A return should be on file for these Illinois residents.

C

Indicates that the partner/shareholder is included on a composite return. These owners should be included on an IL-1023-C Schedule BC.

E

Indicates that Form IL-1000-E was provided to the PTE by the partner or shareholder. A return should be on file since these owners have elected to pay their own liability.

P

New for tax year 2013. Indicates the partnership is a publicly traded partnership which has no obligation to withhold.

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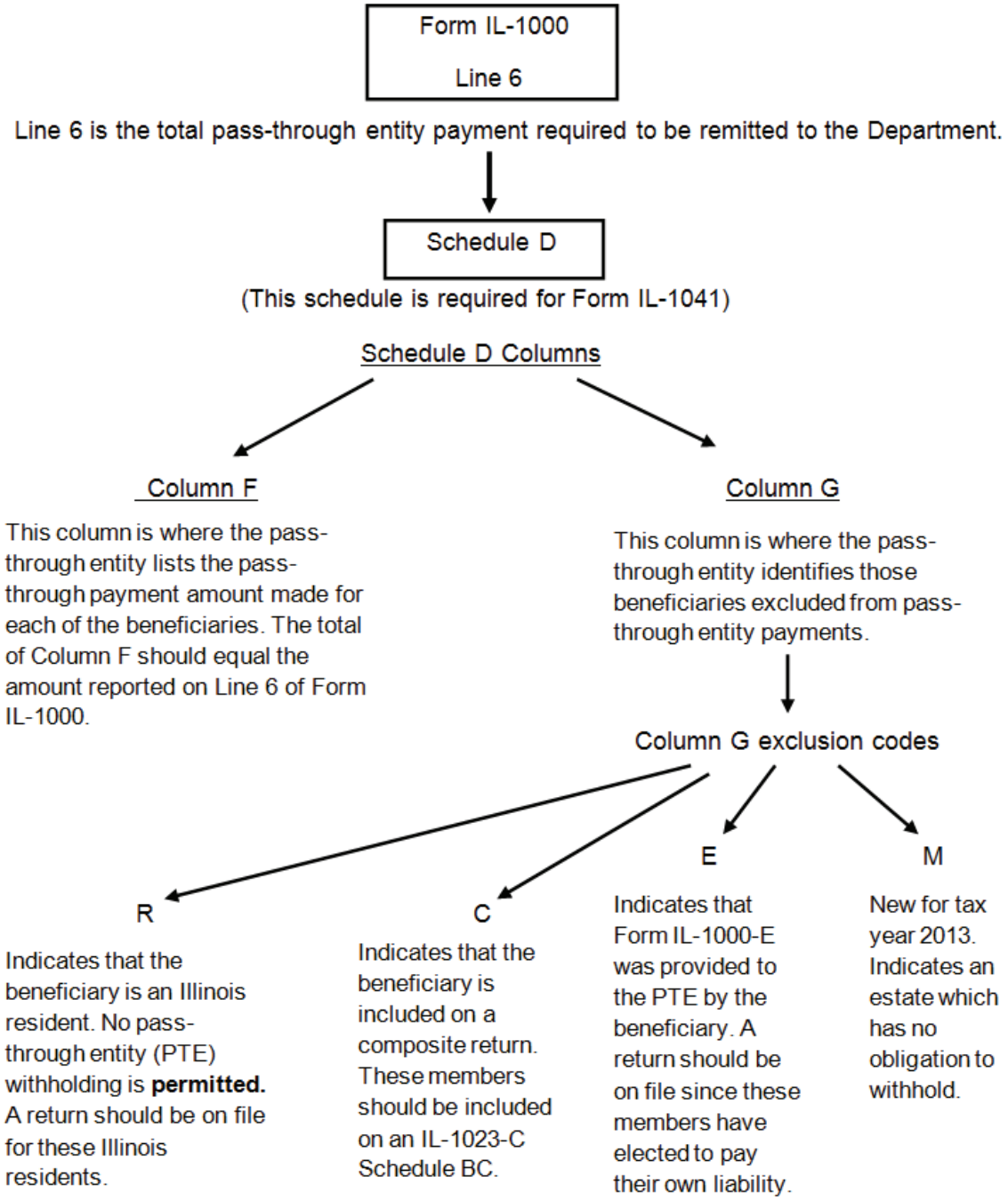
Form IL-1000 Reconciliation Using Schedule D



Note: For tax years 2009 and prior, the Schedule D for the IL-1041 does not have Column G on it. Column G was added to Schedule D starting with the 2010 tax forms.

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Q. Exhibit Q - Example – IL-1000 and IL-1023-C Filed – Overpayment on the IL-1000

The PTE filed Form IL-1000 and paid $921,270 for the 2009 tax year on behalf of their shareholders. They also filed Form IL-1023-C for the 2009 tax year, on behalf of their shareholders, but made no payment for the stated liability. Liability reported on the IL-1023-C was $480,842. The PTE assumed that the Department could transfer any overpayment from the IL-1000 and apply it to the IL-1023-C liability.

Verification of the PTE requirement is necessary to ensure that the proper amount of payment was submitted as follows:

Taxpayer's Schedule B should be exported from GenTax. Note: The figures for "income" on the export do not take into account the taxpayer's apportionment. Therefore, a schedule must be prepared to determine the Illinois portion of the income reflected on the Schedule B. The schedule goes on to figure the tax liability for each shareholder (in this case, all shareholders were nonresidents).

4	shareholder ID	1	2	3	4	5	6	7	8		
5	income per Sch B	$ 19,111,131	$ 1,197,183	$ 15,962,397	$ 3,192,480	$ 3,192,478	$ 3,192,479	$ 3,192,478	$ 4,034,328		$ 53,074,954
6	IL appor	0.235569	0.235569	0.235569	0.235569	0.235569	0.235569	0.235569	0.235569		0.235569
7											
8	IL income	$ 4,501,990	$ 282,019	$ 3,760,246	$ 752,049	$ 752,049	$ 752,049	$ 752,049	$ 950,363		$ 12,502,814
9	tax rate	0.03	0.045	0.045	0.045	0.045	0.045	0.045	0.03		
10	tax liability	$ 135,060	$ 12,691	$ 169,211	$ 33,842	$ 33,842	$ 33,842	$ 33,842	$ 28,511		$ 480,841
11		n/filer	n/filer	PTE $171,311	n/filer	n/filer	n/filer	n/filer	n/filer		
12											
13			0.015	0.015	0.015	0.015	0.015	0.015			
14			0.03	0.03	0.03	0.03	0.03	0.03			
15		R/T tax	$ 4,230	$ 56,404	$ 11,281	$ 11,281	$ 11,281	$ 11,281		$ 105,757	equals tax on R/T sub taken
16		I/T tax	$ 8,461	$ 112,807	$ 22,561	$ 22,561	$ 22,561	$ 22,561		$ 211,514	
17			$ 12,691	$ 169,211	$ 33,842	$ 33,842	$ 33,842	$ 33,842			
18											
19	IL-1000 requirement										
20											
21		3% tax on 2 indiv ($135,060 and $28,511)			$ 163,571						
22		1.5% tax on $7,050,461 R/T subtraction			$ 105,757						
23		3% tax on 6 trusts			$ 211,514						
24					$ 480,842						
25											
26											
27	IL income	$ 12,502,814									
28	R/T sub (after appor)	$ 7,050,461									
29	remaining income	$ 5,452,353	equals figures on BIT return								
30	R/T tax due	$ 81,785	pd with BIT return								

Each shareholder was reviewed to determine if they had filed. If not, all tax liability was due from the PTE (IL-1000). If they had, as was the case of the 3rd shareholder, the PTE credit taken of $171,311 must be verified as to where it was generated from. In this case, $169,211 was from the S corp and the remaining $2,100 from another entity. Therefore, the $169,211 PTE credit taken would also be due on the IL-1000.

This S corporation correctly took a "5d" subtraction (income distributed to shareholder subject to replacement tax) of $29,929,495 on their IL-1120-ST. That figure was verified on the schedule that was prepared. The $29,929,495

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subtraction times the apportionment of .235569 calculates to IL income subtracted of $7,050,461. R/T of 1.5% on that is $105,757.

Since the figures for the IL-1000 come directly from the Schedules K-1-P which were issued, those schedules are required to determine / verify the liability. Per the instructions (starting in 2009), Line 1 of the IL-1000 should be a summation of the figures in Col. B of the Schedules K-1-P issued to the nonresident shareholders. In this example, $12,502,824, Line 2 "individuals" income of $5,452,359 and tax of $163,571. Line 4 "trusts" income of $7,050,465 and tax of $317,271 for a total tax liability on the IL-1000 of $480,842.

3	KIPs Summary										
4	1	2	3	4	5	6	7	8			
5	$ 5,025,302	$ 314,800	$ 4,197,334	$ 839,467	$ 839,467	$ 839,467	$ 839,467	$ 1,060,833			
6	$ (107)	$ (7)	$ (90)	$ (18)	$ (18)	$ (18)	$ (18)	$ (23)			
7	$ (38)	$ (2)	$ (31)	$ (6)	$ (7)	$ (6)	$ (6)	$ (8)			
8	$ 23,550	$ 1,475	$ 19,670	$ 3,934	$ 3,934	$ 3,934	$ 3,934	$ 4,971			
9	$ 249,164	$ 15,609	$ 208,113	$ 41,622	$ 41,622	$ 41,623	$ 41,622	$ 52,598			
10	$ 3	$ -	$ 3	$ -	$ -	$ -	$ -	$ 1			
11	$ 497	$ 32	$ 415	$ 83	$ 83	$ 83	$ 83	$ 105			
12	$ (131,161)	$ (8,217)	$ (109,551)	$ (21,910)	$ (21,911)	$ (21,910)	$ (21,910)	$ (27,688)			
13	$ 5	$ -	$ 4	$ 1	$ 1	$ 1	$ 1	$ 1			
14	$ (19,784)	$ (1,240)	$ (16,524)	$ (3,305)	$ (3,304)	$ (3,305)	$ (3,305)	$ (4,176)			
15	$ (849,663)	$ (53,224)	$ (709,672)	$ (141,934)	$ (141,935)	$ (141,936)	$ (141,936)	$ (179,363)			
16	$ 3	$ -	$ 2	$ -	$ -	$ -	$ -	$ -			
17	$ 432,472	$ 27,091	$ 361,218	$ 72,244	$ 72,244	$ 72,244	$ 72,244	$ 91,294			
18	$ (3)	$ -	$ (2)	$ -	$ -	$ -	$ -	$ -			
19	$ (228,244)	$ (14,298)	$ (190,638)	$ (38,128)	$ (38,128)	$ (38,128)	$ (38,128)	$ (48,182)			
20	$ 4,501,996	$ 282,019	$ 3,760,251	$ 752,050	$ 752,048	$ 752,049	$ 752,048	$ 950,363		$ 12,502,824	should have been line 1 of IL-1000
21										$ 163,571	should have been line 2 tax for individuals
22	3%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	3.00%		$ 317,271	should have been line 4 tax for trusts
23										$ 480,842	should have been tax due on IL-1000
24	$ 135,060	$ 12,691	$ 169,211	$ 33,842	$ 33,842	$ 33,842	$ 33,842	$ 28,511			

Note: The taxpayer is not required to attach the Schedules K-1-P to their return. If the auditor is at the taxpayer location, the Schedules K-1-P should be easily obtainable. The return can be requested from files, if the Schedules K-1-P are not provided by the taxpayer.

The PTE over-reported the income on the IL-1000 ($921,270) and overpaid the tax liability, but they also filed an IL-1023-C reflecting a tax liability of $480,842 which is the correct tax liability. However, in order for the overpayment to be claimed, revised Schedules K-1-P would be issued to the shareholders reflecting the amount paid on the IL-1000. The shareholders would file original or amended returns (as applicable) to make claims for refunds on the overpaid amounts. Claims must be timely and within statute. Any overpayment on the IL-1000 cannot be claimed by the PTE.

The PTE would file an IL-1023-C-X to zero out the original IL-1023-C.

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VI. ARCHIVES

A. Section 444 Returns

For the first taxable year beginning after December 31, 1986

Partnerships/S corporations were allowed an automatic extension of time to file their federal returns under 26 CFR §1.444-3T(c)(1)(i). Whether or not a Section 444 election was made, the due date for filing its income tax return for the first taxable year beginning after December 31, 1986, was the later of:

- The 15th day of the fourth month following the close of the taxable year for partnerships or the 15th day of the third month following the close of the taxable year for S corporations, or
- August 15, 1988.

The words, "SECTION 444 RETURN" should have been, in order to allow the returns to have been processed in the most efficient manner, typed or legibly printed at the top of the federal return, which was filed under these provisions.

Further, based on CFR §1.444-3T(c)(1)(ii), if August 15, 1988 was within 6 months of the 15th day of the fourth month for partnerships (15th day of the third month for S corporations) following the close of the taxable year, the partnership/S corporation may have requested an additional extension of time of 6 months from the original due date of the return by filing Form 7004 by the later of the two dates specified above.

Example 1: A, a partnership that historically used a January 31 taxable year, makes a Section 444 election to retain such year for its taxable year beginning February 1, 1987. Absent the Section 444 return provisions, A's federal Form 1065 for the taxable year ending January 31, 1988, is due on or before May 15, 1988. However, if A types or legibly prints "SECTION 444 RETURN" at the top of the federal Form 1065 for the year, the due date of the return is automatically extended to August 15, 1988.

Example 2: The facts are the same as in Example 1, except that A desires to extend the due date of its return for the year ending January 31, 1988, to a date beyond August 15, 1988. Pursuant to the Section 444 return provisions, A may extend such return to November 15, 1988 (i.e. the date that is up to 6 months after May 15, 1988, the normal due date of the return). However, in order to obtain this additional extension, A must file the federal Form 7004 on or before August 15, 1988.

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Example 3: B, a partnership that historically used a June 30 taxable year, considered making a Section 444 election to retain such taxable year, but eventually decided to change to a December 31 taxable year (B's required taxable year). Absent the Section 444 return provisions, B's federal Form 1065 for the taxable year beginning July 1, 1987 and ending December 31, 1987, is due on or before April 15, 1988. However, if B types or legibly prints "SECTION 444 RETURN" at the top of the federal Form 1065 for the year, the above provisions automatically extend the due date of such return to August 15, 1988.

B. Enterprise Zone Dividends

Section 203(d)(2)(K) currently provides a subtraction modification for "An amount equal to those dividends included in such total which were paid by a corporation which conducts business operations in an Enterprise Zone or zones created under the Illinois Enterprise Zone Act, enacted by the 82nd General Assembly, and which does not conduct such operations other than in an Enterprise Zone or Zones." This subtraction modification was incorporated into the IITA by PA 82-1019, effective December 7, 1982.

PA 83-1114, effective June 8, 1984, amended this subtraction modification for corporations and trusts and estates, but not for partnerships. This Public Act changed the wording to state, "An amount equal to those dividends included in such total which were paid by a corporation which conducts business operations in an Enterprise Zone or Zones created under the Illinois Enterprise Zone Act, and conducts substantially all of its operations in an Enterprise Zone or Zones."

Form 1299-A, which is used to support this subtraction modification for partnerships, was changed as a result of this Public Act to reflect the new language, even though Section 203(d)(2)(K) of the Act was not amended. The change to the 1984 schedule indicates the intent was to include partnerships as well. REF: TAM dated July 26, 1990 from Legal to Research and Communications and TAM dated August 30, 1990 from ITLD-S to TSS.

In order to be eligible for this modification, the corporation from which the dividends are received must:

- Conduct business operations in a federally designated Foreign Trade Zone (or Sub-zone, effective January 1, 1987) located in Illinois and be designated by the Illinois Department of Commerce and Community Affairs as a "High Impact Business", or
- Conduct "substantially all" of its business operations in an Illinois Enterprise Zone or zones.

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In order to determine if a corporation conducts "substantially all" of its operations in an Enterprise Zone, the corporation's property, payroll and sales (including throwback sales) within the Enterprise Zone are compared to the corporation's total property, payroll, and sales everywhere. For tax years ending before January 1, 1987, if the sum of these three factors, divided by three, is 95% or greater, the corporation is considered to have conducted substantially all of its business in an Enterprise Zone. For tax years ending on or after January 1, 1987, the sales factor should be double-weighted and the sum should be divided by four. One-factor filers would use a one-factor test. REF: Sunshine Letter IT87-0068 and TAM dated September 4, 1991 from Legal Services to TSS.

C. Pre-1983 Federal Law

Federal Public Law 97-354, applicable to tax years beginning after December 31, 1982, made important changes to the taxation of S corporations. Under the prior law, an S corporation (which was also referred to as a tax-option corporation) was a corporation which elected not to pay any corporate tax on its income. Instead, it opted to have its shareholders pay taxes on the income.

Federal taxable income of the S corporation was computed at the corporate level in much the same way as it was computed for any other corporation. The shareholders were then taxed directly on this income, whether or not the corporation distributed it to them. Shareholders were also entitled to deduct, on their individual returns, their share of any net operating loss sustained by the corporation, subject to certain limitations. The only exception to this rule was that the tax-option corporation's net capital gain was passed through to its shareholders and treated as a long-term capital gain on their individual returns. The S corporation's accumulated earnings and profits were reduced at the close of the taxable year to the extent that the corporation's undistributed taxable income for the year was required to be included in its shareholder's gross income. This prevented double taxation of the income of an S corporation that was not currently distributed.

D. Contributions to Comm.-Based Organizations Subtraction

PA 84-997, effective January 1, 1986, added a subtraction modification for contributions made to a community-based organization. PA 84-1308 (effective August 25, 1986) amended the modification to include contributions made to "assist local government programs for gang control."
PA 84-1400 deleted this subtraction effective September 18, 1986. Therefore, this modification was in existence only for tax years ending on or after January 1, 1986 and prior to September 19, 1986.

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E. Federal Form 1041-S

Federal Form 1041-S is obsolete for taxable years beginning in 1989. Fiduciaries of simple trusts are required to file federal Form 1041 for taxable years beginning in 1989.

Federal Form 1041-S (effective with taxable years ending December 31, 1986) is a Federal return for nontaxable simple trusts. A fiduciary may use the federal Form 1041-S to report the income and deductions of a simple trust. Trusts that do not meet the filing requirements listed below, and are otherwise required to file an income tax return, must use a federal Form 1041.

The federal Form 1041-S can only be used by a domestic "simple trust" that has:

- No tax liability,
- No amounts reportable on Schedule D (Capital gains and losses),
- No charitable contribution deduction,
- No rental income, loss, or credit,
- No other passive activity income, losses or credits, and
- A trust instrument that requires all of the current income of the trust to be distributed to the beneficiary(ies) during the tax year.

If a simple trust receives income from passive activities (e.g. rental income), federal Form 1041-S cannot be used.

F. Accumulation and Capital Gain Distributions Credit

IITA § 601(b)(4) provides that:

> If the net income of a taxpayer includes amounts included in his base income by reason of IRC § 667 (relating to accumulation and capital gain distributions by a trust, respectively), the tax imposed on such taxpayer by this Act shall be credited with his pro rata portion of the taxes imposed by this Act on such trust for preceding taxable years which would not have been payable for such preceding years if the trust had in fact made distributions to its beneficiaries at the times and in the amounts specified in IRC §666 and §669. The credit provided by this paragraph shall not reduce the tax otherwise due from the taxpayer to an amount less than that which would be due if the amounts included by reason of IRC §667 were excluded from base income."

Effective for tax years beginning after December 31, 1975, this credit is no longer available to individuals. For years prior to 1987, the IL-2210 had a line for "Tax

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credit for accumulation distribution claimed on IL-1040." Therefore, individual taxpayers may attempt to claim this credit. It should be disallowed per audit.

G. History of IRC Sec. 1348

IRC Sec. 1348(b)(1) is the measure of the PSI alternative in the 35 ILCS 5/203(d)(2)(H) subtraction modification.

The history of IRC Sec. 1348 is discussed in *Kampel v. Cir* (CA-7) 634 F.2d 708 (1980). It states that the Revenue Act of 1978 amended IRC Sec. 1348 to remove the IRC Sec. 911(b) 30% limitation on the computation of PSI, which limited a Partner's IRC Sec 911(b) "reasonable compensation" to 30% of Partnership Profits. Subsequently, Congress repealed IRC Sec. 1348 (effective August 31, 1981, P.L. 97-34). In response to Congress' repeal of IRC Sec. 1348, the Illinois Legislature amended 35 ILCS 5/203(d)(2)(H) by adding the following words "as in effect December 31, 1981" behind the words "Sec. 1348(b)(1) of the Internal Revenue Code," thereby sustaining the PSI alternative for the 35 ILCS 5/203(d)(2)(H) subtraction modification.

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HOLDING COMPANIES

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A. IAC Section 100.TABLE B 9

I. PURPOSE

This chapter contains information discussing the unitary determination for a holding company and its inclusion in the unitary group and the allocation of holding company income and factors between more than one unitary business group.

II. REFERENCE SOURCES

A. Illinois Income Tax Act (IITA)

Section 304 Business Income of Persons other than Residents
- (a) In General
- (b) Insurance Companies
- (c) Financial Organizations
- (c-1) Federally Regulated Exchanges
- (d) Transportation Services
- (f) Alternative allocation
- (h) For tax years on or after December 31, 1998

Section 1501(a)(8) Financial Organization
Section 1501(a)(27) Unitary Business Group

B. Illinois Administrative Code (IAC)

Section 100.9700 Unitary Business Group Defined
Section 100.9710 Financial Organizations

III. GENERAL INFORMATION

A. Holding Company

A holding company is generally formed to hold the stock of one or more corporations. A holding company may also own liabilities of its subsidiaries. Holding companies frequently leverage their ownership of subsidiaries by issuing bonds, and may provide support services for their subsidiaries, such as tax and accounting services, employee benefit packages and centralized purchasing of insurance and legal services. Holding companies can appear in any tier of a corporate structure and can perform a large variety of functions or virtually no functions at all. A holding company that is itself a subsidiary of another company is called an “intermediate” holding company.

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Companies that conduct substantial business activities may own stock in subsidiaries, but are not generally referred to as holding companies and do not present the holding company issues discussed in this chapter. Accordingly, for purposes of this chapter, "holding company" does not refer to a company with substantial business activities unrelated to its ownership of subsidiaries.

B. Unitary Determinations

Holding companies are subject to the same unitary determination tests as any other type of company. However, the criteria commonly used to establish a unitary relationship may not apply to a holding company since the criteria itself may not exist. For instance, a large amount of intercompany sales between two companies is generally considered a strong indicator of the existence of a unitary relationship. If a holding company does not purchase or sell inventory, the criteria itself does not exist. Therefore, a lack of intercompany sales will not be a factor in the unitary determination.

Holding companies having no (or relatively few) operations must still be functionally integrated through the exercise of strong centralized management with their controlled subsidiaries and/or affiliates in order to be considered unitary with those affiliates. The activities of the holding company must exceed what is commonly regarded as normal stewardship function (i.e. the management must contribute to the integration of the companies and not just fulfill normal investment oversight responsibilities). This problem is mitigated to some extent by the fact that a holding company, with so little activity that it is difficult to determine if its activities are unitary with its subsidiaries' activities, will also have little or no income or expense, so that the consequences of including or excluding it from a unitary group may not be material.

C. Repealed at 43 Ill. Reg. 10124, effective August 27, 2019 - IAC Section 100.TABLE B

This noncombination example for holding companies has been repealed due to its inconsistency with the elimination of the noncombination rule by PA 100-0022 effective 7/6/2017. See the Historical Extract section for more information.

IV. APE SPECIFIC LAW APPLICATIONS

A. Court Cases on Unitary Relationship

The following cases are examples that support Illinois' position for including holding companies in a unitary group. A synopsis can be found in Chapter 49 Court Cases.

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1. Appeal of PBS Building Systems, Inc., and PKH Building Systems, Inc., California State Board of Equalization, 94-SBE-008, November 17, 1994

2. Consol, Inc. v. Bower, Cook County Cir. Ct., Dkt. No. 01 L 51196, 4/7/2003

B. Apportionment Method

A holding company with no business operations would not generally qualify to use the one-factor insurance company, financial organization or transportation company formulas, and so would use the single sales factor apportionment formula under IITA §304(h)(3) (for tax years on and after December 31, 2000). An exception to this general rule applies to bank holding companies which are included in the financial organization definition contained in IITA §1501(a)(8).

A holding company that qualifies as a bank holding company under the Bank Holding Company Act of 1956 is, by statutory definition, a financial organization and any subsidiary it owns is also a financial organization, regardless of the actual business operations of the holding company or subsidiary. One exception to this rule is that subsidiaries that must be disposed of within certain required time limits under the Bank Holding Company Act of 1956 may be included in the same unitary group with the bank holding company only if they qualify as a financial organization under some other provision of IITA §1501(a)(8). Hereafter, companies that do not qualify as financial organizations under the Bank Holding Company Act of 1956 will be referred to as nonbanking.

1. Tax Years ending on or after December 31, 2017

For tax years ending on or after December 31, 2017 PA 100-0022 eliminated the non-combination rule. The definition of "United States" was also changed to include members operating in any area over which the U.S. has asserted jurisdiction or claimed exclusive rights with respect to the exploration for or exploitation of natural resources (e.g. the Outer Continental Shelf).

The method of prorating the income of a holding company included in multiple unitary business groups, described in subparagraph C of IITA § 1501(a)(27), has not changed, but has become obsolete with the repeal of the non-combination rule. Holding companies should just use the single sales factor apportionment on the Schedule UB.

More information on different apportioning companies and combination can be found in the instructions for the Schedule UB and Subgroup Schedule UB.

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2. Tax Years ending on or after December 31, 1987 and prior to December 31, 2017

Since the definition of "unitary group" in IITA §1501(a)(27) was enacted by PA 82-1029, it has provided that companies required to apportion their business income under different subsections of IITA §304 could not be combined. In 1987, PA 85-731 created an exception to this noncombination rule for holding companies that owned a group of insurance companies or a group of transportation companies. PA 97-0507, effective August 23, 2011, amended the exception for certain holding companies to apply to financial organizations and multiple holding companies, and to allow splitting of holding companies among groups. This legislation was designed to codify existing practice. The definition of when to split a holding company was also expanded (IITA §1501(a)(27)(C)).

PA 97-0636 effective December 16, 2011 updated the section to include federally regulated exchanges.

IITA 1501(a)(27)(B) now states:

> … In no event, shall any unitary business group include members which are ordinarily required to apportion business income under different subsections of Section 304 except that for tax years ending on or after December 31, 1987 this prohibition shall not apply to a holding company that would otherwise be a member of a unitary business group with taxpayers that apportion business income under any of subsections (b), (c), (c-1), or (d) of Section 304. If a unitary business group would, but for the preceding sentence, include members that are ordinarily required to apportion business income under different subsections of Section 304, then for each subsection of Section 304 for which there are two or more members, there shall be a separate unitary business group composed of such members. For purposes of the preceding two sentences, a member is "ordinarily required to apportion business income" under a particular subsection of Section 304 if it would be required to use the apportionment method prescribed by such subsection except for the fact that it derives business income solely from Illinois. As used in this paragraph, the phrase "United States" means only the 50 states and the District of Columbia, but does not include any territory or possession of the United States or any area over which the United States has asserted jurisdiction or claimed exclusive rights with respect to the exploration for or exploitation of natural resources.

P.A. 097-0507 created subparagraph (C) for holding companies in IITA § 1501(a)(27) which defines "holding company" as a corporation (other than a corporation that is a financial organization under paragraph 1501(a)(8) of the IITA because it is a bank holding company or is owned by a bank holding company)…that, during the current tax year and the two immediately preceding tax years, derives substantially all of its gross

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income from dividends, interest, royalties, fees or other charges from controlled taxpayers for providing services to the unitary group.
These corporations incur no substantial expenses other than expenses (including interest and other costs of borrowing) incurred in connection with the acquisition and holding of interests in subsidiaries and in the provision of services to subsidiaries or in the leasing or licensing of property to subsidiaries.

Subparagraph (C) also describes the method of prorating the income of a holding company included in multiple unitary business groups.

a) Allocation Between Unitary Groups

A holding company may be unitary with two or more unitary groups of subsidiaries that are either not unitary with each other or are prohibited by the noncombination rule from being one unitary group. In these instances, it is necessary to allocate the base income (loss) and apportionment factors of the holding company to each of the groups.

According to IITA §1501(a)(27)(C)(ii) and (iii) the income and factors of a holding company, which is a member of more than one unitary business group, shall be included in each unitary business group of which it is a member by pro rating its base income in a proportion equal to that which the gross receipts of the unitary business group bears to the combined gross receipts of all unitary business groups. The business income of the holding company will be apportioned under the subsection of 304 used by the other members of its unitary business group.

The method most supported for allocating the holding company's income and factors between unitary groups is comparative gross receipts, but any other "reasonable" method may be used if it is consistently applied and provides a reasonable measure of business activity and income.

The comparative gross receipts method prorates a holding company's income (loss) and factors among the unitary groups based on a ratio of each group's gross receipts as compared to the gross receipts of all the unitary groups. A potential problem with this method is that sometimes revenues of different businesses are not comparable (i.e. product sales of a manufacturing company and insurance premiums from an insurance company).

Example 1: Holding Company HC files a consolidated federal 1120 return with companies I, which is engaged in the manufacturing business, and J, which is engaged in the retail business. HC is unitary with companies I and J. Companies I and J are NOT unitary with each other. The auditor determines that the income and factors of HC should be split between companies I and J according to IITA §1501(a)(27)(C)(ii). Company I has gross receipts from its manufacturing business of $700 million and Company J has gross receipts of $300 million from its retailing

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business. In this case, 70% ($700,000,000/$1,000,000,000) of the base income and factors of HC would be included in the unitary group with I and 30% ($300,000,000/$1,000,000,000) of the income and factors of HC would be included in the unitary group with J.

Example 2: Same as above except HC is a pure holding company-it has no payroll or property, its only income is dividends from I and J, and its only expenses are interest, taxes and fees. HC has no real business, so it would be inappropriate to tax it separately from I and J. However, its leveraged ownership of I and J is not enough to make I and J unitary. The expenses of HC should be split between companies I and J per the guidance of IITA §1501(a)(27)(C)(ii). Company I has gross receipts from its manufacturing business of $700 million and Company J has gross receipts of $300 million from its retailing business. In this case, 70% ($700,000,000/$1,000,000,000) of the expenses of HC would be included in the unitary group with I and 30% ($300,000,000/$1,000,000,000) of the expenses of HC would be included in the unitary group with J.

Example 3: Holding Company HC files a consolidated federal 1120 return with companies K, L, and M, which are engaged in the manufacturing business, and companies O, P, and Q, which are engaged in the retail business. HC is unitary with all of the above companies. Companies K, L, and M are unitary with each other and O, P, and Q are unitary with each other. However, the manufacturing and retailing groups are NOT unitary with each other. The auditor determines that the income and factors of HC should be split between the manufacturing and retailing groups. HC's income consisted exclusively of a $100 million capital gain from the sale of Company N which was engaged in the retailing business and was unitary with companies K, L, and M before it was sold. In this case, all of HC's income and factors should be included in the retailing group with companies K, L, and M.

Example 4: For the year ending December 31, 2011, Holding Company HC files a consolidated federal 1120 return with companies G and H. Company HC is a Bank Holding Company and companies G and H are properly ownable under the Bank Holding Company Act of 1956. Companies HC, G, and H are required to file a combined unitary return using the financial organization apportionment formula in IITA §304(c) even if company G or H would not be a financial organization under IITA §1501(a)(8) except for the fact that it was owned by a Bank Holding Company.

3. Tax Years ending on or after December 31, 1982 and prior to December 31, 1987

A three-factor holding company that was unitary with a transportation, insurance or nonbanking financial organization unitary group could not be included in the one factor transportation, insurance or nonbanking financial unitary group due to the statutory

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prohibition against combining companies with differing apportionment formulas in one unitary group, which is referred to as the noncombination rule.

The noncombination rule provides that any person who would be a member of a unitary business group but uses another apportionment method must file a separate unitary return with any other unitary members that use its apportionment method. If there are no other members using that method, the member must file a separate non-unitary return.

C. Exercising Election to Not Split Holding Company

The holding company may petition the Director, pursuant to IITA § 304(f), to include all income and factors of the holding company only with members of a unitary business group apportioning their business income under one subsection ((a), (b), (c) or (d)) of IITA § 304, if including the income and factors of the holding company in more than one unitary business group does not fairly reflect the degree of integration, dependence of, and contributions between the holding company and one or more of the unitary business groups.

D. 80/20 Corporations Owned by a Holding Company

In some cases, auditors will have to determine the proper method of allocating the income and factors of a holding company that is unitary with domestic subsidiaries engaged in several unitary groups and is also unitary with subsidiaries that have been excluded from any unitary group because they qualify as 80/20 corporations. Since a unitary relationship exists between the holding company and the 80/20 companies, the question that has been asked is whether any portion of the income (loss) and factors of the holding company should be allocated to the 80/20 companies.

1. Policy on and after July 24, 1997

The holding company allocation policy when 80/20 companies are involved was changed on July 24, 1997. When a holding company owns unitary subsidiaries engaged in several unitary groups and unitary subsidiaries that qualify as 80/20 corporations which are excluded from any unitary group because of the 80/20 rule, the correct approach is to not allocate any of the income (loss) and factors of the holding company to the “80/20 group”. In other words, the entire income (loss) and factors of the holding company should be allocated to the domestic unitary groups.

2. Policy Prior to July 24, 1997

Prior to July 24, 1997, Legal Services advised the Audit Bureau on the proper method of allocating the income (loss) and factors of a holding company when the holding company owned subsidiaries engaged in several unitary groups and subsidiaries that

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were excluded from any unitary group by the 80/20 rule. Legal recommended that in situations where the holding company was unitary with the 80/20 companies, the 80/20 companies be put into a separate "80/20 group" and a portion of the income (loss) and factors of the holding company should be allocated to the "80/20 group".

V. HISTORICAL EXTRACTS

A. IAC Section 100.TABLE B

IAC Section 100.TABLE B contained an example of a combined apportionment method for unitary groups, which are comprised of members using single-factor and three-factor apportionment formulas.

TABLE B was inconsistent with the new holding company legislation, which provides that business income of a holding company included in a one-factor unitary group shall be apportioned using that one-factor formula and should not be consulted.

The Department enacted legislation (PA 100-0022) that repealed the noncombination rule, and therefore repealed Section 100.TABLE B.

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FINANCIAL ORGANIZATIONS

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I. PURPOSE

This chapter contains a discussion of the different types of financial entities and the apportionment factor for financial organizations, as well as subtraction modifications unique to financial organizations. Also included is the sales finance company definition contained in Public Act (PA) 91-535. The primary and effective regulations for financial organizations are the following: IAC §§ 100.9710, 100.3400, 100.3405, 100.2655, 100.2657. and 100.2455.

For financial organizations filing returns for tax years ending on or before December 31, 1996, who may be eligible to utilize the proposed regulations stated in IITA §1501(a)(8)(E), please contact Income Tax Technical Support for further guidance.

PA 95-233 and 95-707 amended the financial apportionment factor found in IITA § 304(c), creating and updating IITA § 304(c)(3). For taxable years ending on or after December 31, 2008, gross receipts are sourced using IITA § 304(c)(3). For taxable years ending before December 31, 2008, gross receipts are sourced using IITA § 304(c)(1).

The most recent changes to IITA § 1501(a)(8), the financial organization definition, are contained in PA 91-535. These changes are declaratory of existing law and are, therefore, retroactive. This public act does not, however, contain any refund or notice limitation language. Except as discussed below, if a person qualifies as a sales finance company under the PA 91-535 definition, it is a sales finance company for ALL tax years.

Effective July 6, 2017, PA 100-22 modified the unitary business group (UBG) definition in IITA § 1501(a)(27)(B). It repealed the noncombination rule and expanded the definition of "United States" to include the outer continental shelf (OCS) for taxable years ending on or after December 31, 2017. Financial organizations that apportion under IITA § 304(c) will combine with companies that apportion under other subsections of IITA § 304. This is a major adjustment to how auditors determine the UBG and combined apportionment, and eliminates the related-party expense modifications for noncombination companies for the applicable tax periods. For more information, see Audit Manual Chapters 23 for UBGs, 24 & 25 for modifications, and 27 for apportionment. Also see the "APPORTIONMENT FORMULA- TYE ON OR AFTER 12/31/08" and "Related-Party Transactions for Noncombination Companies for Taxable Years Ending on or after December 31, 2017" sections in this chapter.

II. REFERENCE SOURCES

- PA 89-711, 91-535, 95-233, & 95-707
- IITA §§ 304(c), 1501(a)(8), 203(b)(2)(M), 203(b)(2)(M-1), 203(b)(2)(I), & 1501(a)(27)(B)
- IAC §§ 100.9710, 100.3400, 100.3405, 100.2655, 100.2657, & 100.2455

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- IRC §§ 1504(a) & (b), 316, 243, 167, 581, 7701(a), 864, 291, & 265
- 26 CFR § 1.864-7
- Letter Rulings
  - Since 2000 (not exhaustive): IT 11-0010-GIL, IT 11-0001-PLR, IT 10-0002-PLR, IT 10-0001-PLR, IT 03-0006-PLR, IT 02-0006-PLR, IT 01-0006-PLR, IT 01-0004-PLR, IT 01-0003-PLR, IT 01-0002-PLR
  - Within this chapter: IT 98-0007-PLR, IT 92-137, IT 92-02

III. GENERAL INFORMATION

A. QUALIFICATIONS TO BE FINANCIAL ORGANIZATION

The statutory definition for a financial organization is found under IITA § 1501(a)(8)(A), and IAC § 100.9710 provides a thorough explanation and basis of determining whether an entity should be treated as a financial organization. A brief summary of the criteria found in that regulation follows.

An exhaustive list of entities that are deemed financial organizations are the following:

- bank
- bank holding company
- trust company
- savings bank
- industrial bank
- land bank
- safe deposit company
- private banker
- savings and loan association
- building and loan association
- credit union
- currency exchange
- cooperative bank
- small loan company
- sales finance company
- investment company
- any person owned by a bank or bank holding company

If an entity is a bank, bank holding company, or owned by a bank or bank holding company as defined in IAC § 100.9710(e) through (g), it qualifies as a financial organization regardless of its business activities. Any of the other entities in the exhaustive list must be

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predominantly engaged in the business activities of a financial organization in order to qualify as a financial organization. This means that more than 80% (50% in the case of a sales finance company) of averaged gross income from the current and two previous taxable periods must come from the characteristic business activities defined for each separate entity in IAC § 100.9710(d). That analysis is referred to in our regulations as the "gross income test". The gross income test only considers the years the entity is in business, so if the entity has only been in business for one or two years, the gross income would only be averaged over one or two years. Some points to consider with the gross income test are the following:

- Income from transactions occurring outside of the ordinary course of business is not included in the gross income test.
- Income not included in apportionable business income is not included in the gross income test.
- Only the net gain (but not loss) from the sale or disposition of any asset is included.
- A "finance lease" is treated as a loan or extension of credit, where the lessor is the creditor and the lessee is treated as the owner and entitled to deduct depreciation expense under IRC § 167.
- If an entity is involved in more than one of the businesses listed in IAC § 100.9710(d) (e.g., small loan company and currency exchange), gross income from financial services includes gross income derived from all services characteristic of any specifically defined type of financial organization for which it qualifies.
    - Example: If a taxpayer receives 45% of its gross income from transactions characteristic of a small loan company and 40% of its gross income from transactions characteristic of a currency exchange, it meets the 80% gross income test and qualifies as a financial organization.

The auditor should consult IAC § 100.9710(a) through (c) for more detail.

1. Calculating Gross Receipts Test: Example

Company A, a credit union, is under audit for TYE 12/31/15 and 12/31/16. Company A originally apportioned its income under IITA § 304(c)(3) as a financial organization. The auditor seeks to verify this by performing the gross receipts test found under IAC § 100.9710(b). The process can be summarized by the following steps:

1. Determine the gross business receipts included in apportionable business income for the audit year and its previous two years
2. Calculate the average gross business receipts for the three-year period
3. Determine the gross business receipts associated with the characteristic services for the financial organization type(s) for the audit year and the previous two years
4. Calculate the average financial gross business receipts for the three-year period

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5. Divide the average gross financial business receipts by the average gross business receipts
6. If the percentage is greater than 80%, the taxpayer qualifies as a financial organization under IAC § 100.9710(b) for that year

These steps should be conducted for each audit period. A taxpayer could qualify as a financial organization in one audit period, but not another, within the same audit cycle. Remember to consider the specific rules of what income to include under IAC § 100.9710(b)(1) – (5).

The auditor follows these steps for Company A and computes the calculation, supporting that Company A should be treated as a financial organization for the audit cycle. The following table summarizes the auditor's gross receipts test:

Company A, Financial Organization Gross Receipts Test

TYE 12/15 Test	TYE 12/15	TYE 12/14	TYE 12/13	Average
Fin. Receipts	55,000,000	51,500,000	42,950,000	49,816,667
Gross Receipts	60,000,000	59,250,000	56,290,000	58,513,333
			Percent	85.14%

TYE 12/16 Test	TYE 12/16	TYE 12/15	TYE 12/14	Average
Fin. Receipts	52,000,852	55,000,000	51,500,000	52,833,617
Gross Receipts	68,500,000	60,000,000	59,250,000	62,583,333
			Percent	84.42%

The auditor's calculations show that the average gross financial business receipts were greater than 80% for both audit periods, confirming that Company A was correct in apportioning its income as a financial organization.

B. NEXUS

Financial organizations, like any other type of taxpayer, must have Illinois nexus in order to be subject to taxation. A legal explanation of nexus can be found in IT 08-0031-GIL:

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> The United States Constitution limits a state's power to subject to income tax foreign corporations and other nonresidents. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction the state seeks to tax. (Quill Corp. v. N. Dakota, 504 U.S. 298 (1992)) The Commerce Clause requires that a state's tax be applied only to activities with a substantial nexus to the taxing state. (Id.) In the case of foreign corporations, Illinois may assert nexus to tax unless the corporation falls under the protection conferred by Public Law 86-272. (15 U.S.C. § 381) Public Law 86-272 precludes a state from subjecting a nondomiciliary corporation to a net income tax where such corporation's only activities within the state for the taxable year consist of solicitation activities for sales of tangible personal property.

Thus, regardless of state statutes, which govern a state's apportionment of income, that income cannot be taxed unless the entity to be taxed has nexus with the state according to U. S. Constitutional jurisprudence. While the Due Process Clause is generally regarded as an easier threshold to meet, the Commerce Clause is regarded as a higher threshold that requires "substantial nexus". In other words, it is entirely possible for a company to have an Illinois apportionment factor due to Illinois tax laws, but not have the requisite "substantial nexus" with the company to establish nexus and subject the company to Illinois income tax.

The distinction between an apportionment factor and nexus is stated in our regulations under IAC § 100.9720(a):

> IITA Section 201(a) imposes the Illinois Income Tax, a tax measured by net income, on *individuals, corporations, trusts and estates for the privilege of earning or receiving income in or as a resident of this State*. IITA Section 201(c) imposes a second tax measured by net income, the Personal Property Tax Replacement Income Tax, on *corporations, partnerships and trusts for the privilege of earning or receiving income in or as a resident of this State*. In general, a resident of this State will always be subject to these taxes. Activity conducted in interstate commerce may establish sufficient nexus with Illinois to permit imposition of these taxes on a non-resident taxpayer, as well, when the non-resident earns or receives income in this State within the meaning of the IITA. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S. Ct. 1076 (1977); Quill v. North Dakota, 504 U.S. 298, 112 S. Ct. 1904 (1992). However, the fact that Article 3 of the IITA requires a non-resident taxpayer to allocate or apportion income to this State does not create a presumption that the taxpayer has nexus. [Emphasis added]

If a financial organization is a member of a UBG, an Illinois nexus determination must be made before including any of its Illinois sales in the combined UBG apportionment factor numerator. The bright-line test of property and payroll from *Quill* (1992) strictly only applied to sales and use tax (*Borden Chemicals and Plastics, L. P.* (2000)) and was overturned in *South Dakota v. Wayfair, Inc.*, U.S. S.Ct., Dkt. No. 17-494, 06/21/2018.

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It is possible to develop a nexus position for a nonresident financial organization that does not have property or payroll in Illinois. We believe the West Virginia Supreme Court case of *Tax Commissioner of the State Of West Virginia v. MBNA America Bank, N.A.*, 640 SE2d 226 (2006) is an instructive case involving a nonresident financial organization. Some principal facts from the opinion are shown below:

> Appellant MBNA America Bank is a foreign corporation which has its principal place of business and commercial domicile in Wilmington, Delaware. During the two years in question, 1998 and 1999, MBNA had no real or tangible personal property and no employees located in West Virginia. The principal business of MBNA at the relevant times in this case was issuing and servicing VISA and MasterCard credit cards. This business included the extension of unsecured credit to customers who use these credit cards. MBNA promoted its business in West Virginia via mail and telephone solicitation.
>
> As noted above, the two tax years at issue are 1998 and 1999. In 1998, MBNA's gross receipts attributable to West Virginia customers amounted to $8,419,431.00, and in 1999, its gross receipts amounted to $10,163,788.00. For tax year 1998, MBNA paid a West Virginia Business Franchise Tax **1** of $32,010.00 and a West Virginia Corporation Net Income tax **2** of $168,034.00. For tax year 1999, MBNA paid a Business Franchise Tax in the amount of $42,339.00 and a Corporation Net Income Tax in the amount of $220,897.00.

MBNA argued that it had no physical presence in West Virginia and that its business activity would not create the necessary substantial nexus to overcome the Commerce Clause. The court disagreed. An excerpt of its reasoning is shown below:

> Accordingly, we now hold that the United States Supreme Court's determination in Quill Corp. v. North Dakota, **504 U.S. 298** , **112 S.Ct. 1904** , **119 L.Ed.2d 91 (1992)** , that an entity's physical presence in a state is required to meet the "substantial nexus" prong of Complete Auto Transit, Inc. v. Brady, **430 U.S. 274** , **97 S.Ct. 1076** , **51 L.Ed.2d 326 (1977)** , applies only to state sales and use taxes and not to state business franchise and corporation net income taxes.
>
> Rather than a physical presence standard, this Court believes that a significant economic presence test is a better indicator of whether substantial nexus exists for Commerce Clause purposes. At least one legal commentator has suggested such a test and to some degree defined its parameters. *See* Edson, 49 Tax Lawyer at 943. According to this commentator, a substantial economic presence standard "incorporates due process 'purposeful direction' towards a state while examining the degree to which a company has exploited a local market." *Id.* Further, "[a] substantial economic presence analysis involves an examination of both the quality and quantity of the company's economic presence." *Id.,* 49 Tax Law. at 944. Finally, under this test, "[p]urposeful direction towards a state is analyzed as it is for Due Process Clause

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purposes," and the Commerce Clause analysis requires the additional examination of "the frequency, quantity and systematic nature of a taxpayer's economic contacts with a state." *Id.,* 49 Tax Law. at 945. We find this rationale persuasive and will apply it in determining the constitutionality of the taxes at issue.

The record showed that MBNA had continuously and systematically engaged in direct mail and telephone solicitation and promotion in West Virginia. This led to significant gross receipts from West Virginia customers of roughly $8.4 million in 1998 and $10.1 million in 1999 . Thus, the court had "no trouble concluding that MBNA's systematic and continuous business activity in this State produced significant gross receipts attributable to its West Virginia customers which indicate a significant economic presence sufficient to meet the substantial nexus prong of *Complete Auto.*" An appeal by the taxpayer to U. S. Supreme Court was denied.

Audit developed a nexus questionnaire in order to assist auditors in determining whether a financial organization has sufficient activity in Illinois to assert nexus: EDA-132-NF Nexus Questionnaire for Financial Companies. This form is available on the Intranet under "Work Areas", "Audit", "Forms", "Income Tax", or at the following link:

https://rev.portal.illinois.gov/Core/Forms/Documents/EDA-132-NF.pdf

For more information about nexus, see Audit Manual Chapter 22.

C. FINANCIAL ORGANIZATIONS- DEFINITIONS AND DISCUSSION BY TYPE OF ENTITY

Each of the following types of entities are detailed in IAC § 100.9710(d)(1) through (11), (e), (f), and (g), which should be referred to for the determination of a financial organization. The following section will list each entity, summarize each one's characteristic services, and its regulation cite. Since this is meant to be an exhaustive list of financial organizations, the auditor cannot classify a company as a financial organization if it is not treatable as one of the listed types of companies.

1. Bank

The characteristic services of a bank as stated by Illinois and federal regulations are the following:

- accepting deposits
- making loans
- discounting evidences of debt

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- buying and selling exchange

An entity formed under another state's laws must engage in each of the above activities to be considered a bank. For example, if the entity did not accept deposits, it could not be considered a bank.

For purposes of applying the 80% gross income test, the following are examples of gross income from characteristic services of a bank:

- application and origination fees, points, interest, late payment fees, and other charges received in connection with loans or with commitments to make loans or provide other credits
- service charges and early withdrawal or other penalties received in connection with deposit accounts
- fees and gains realized from buying and selling exchange, including foreign currency
- loan servicing fees and charges received in connection with syndicated loans or loans sold to third parties
- discounts and gains realized on the purchase or resale of loans

Examples of items that ARE NOT considered income from characteristic services of a bank include rental income from real estate, gains from the sale of property obtained in foreclosure or settlement of loans, and income earned from securities (interest, dividends, and gains). This is in line with the rule that only income earned in the ordinary course of an entity's business should be included in the 80% gross income test.

See IAC § 100.9710(d)(1) for more information.

An entity may be considered a bank, even if it does not conduct the characteristic activities of a bank and meet the 80% gross income test, if the entity is one of the following:

- regulated by the Office of the Comptroller of the Currency (OCC)
- regulated by the Federal Reserve Board (FRB)
- regulated by the Federal Deposit Insurance Corporation (FDIC)
- a federally or state-chartered bank operating as a credit card bank.

The auditor can verify through each regulator's website whether a specific taxpayer is regulated by the agency. The OCC's website provides lists of its regulated banks showing a charter number (issued by the OCC), a certificate number (issued by the FDIC), and an RSSD number (a unique identifier issued by the FRB). Likewise, the

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auditor can obtain similar information from the FDIC and FRB's websites to verify regulation information about a specific taxpayer.

See IAC § 100.9710(e) for more details.

2. Trust Company

The characteristic services of a trust company as stated by Illinois regulations are the following:

- performing services as fiduciary on behalf of beneficiaries
- rendering services to the trust

For purposes of applying the 80% gross income test, only trustee fees or other compensation for services rendered as trustee to the trust should be considered as income from characteristic services.

Amounts received for services provided other than as a trustee ARE NOT to be treated as income from characteristic services of a trust company. An example of this would be fees received as advisor or manager of a mutual fund in which trust fund assets are invested.

See IAC § 100.9710(d)(2) for more information.

3. Savings Bank

A distinguishing characteristic of a savings bank is that, per Illinois regulations, it must maintain 60% of its total assets in qualifying "domestic savings and loan association" assets described in IRC § 7701(a)(19). The characteristic services of a savings bank as stated by Illinois and federal regulations are the following:

- acquiring the savings of the public
- investing in loans

Like a regular bank, if a savings bank is not taking deposits, it would not qualify as a financial organization for purposes of the IITA.

For purposes of applying the 80% gross income test, examples of income from characteristic services are the following:

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- application and origination fees, points, interest, late payment fees, and other charges received in connection with loans or with commitments to make loans or provide other credits
- service charges and early withdrawal or other penalties received in connection with deposit accounts
- loan servicing fees and charges received in connection with syndicated loans or loans sold to third parties
- discounts and gains realized on the purchase or resale of loans

Like banks, examples of items that ARE NOT considered income from characteristic services of a savings bank include rental income from real estate, gains from the sale of property obtained in foreclosure or settlement of loans, and income earned from securities (interest, dividends, and gains).

See IAC § 100.9710(d)(3) for more information.

4. Land Bank

Land banks were created under federal law to make loans on farm security at low interest rates. Under current law, these surviving entities ARE EXEMPT from Illinois taxation. The characteristic service is the following:

- making loans to farmers

For purposes of applying the 80% gross income test, examples of income from its characteristic service is the following:

- application and origination fees, points, interest, late payment fees, and other charges received in connection with farm loans

See IAC § 100.9710(d)(4) for more information.

5. Safe Deposit Company

A safe deposit company is licensed under Illinois statutes, which do NOT apply to banks, savings and loans, credit unions, warehouses, or grain storage companies.

The characteristic service of a safe deposit company is the following:

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- providing facilities for the safekeeping of personal property in safes or vaults

For purposes of applying the 80% gross income test, the example of income from its characteristic service is the following:

- rental income or similar charges for safe deposit boxes

See IAC § 100.9710(d)(5) for more information.

6. Savings and Loan Association

Savings and loan associations can be organized under either federal or Illinois statutes. These entities, like savings banks, are required to invest 60% of their assets in "domestic savings and loan association" assets described in IRC § 7701(a)(19). Regardless of other law, for purposes of the IITA, the determination of a savings and loan association will be by its following characteristic services:

- acquiring the savings of the public
- investing in loans

Like a regular bank, if a savings and loan association is not taking deposits, it would not qualify as a financial organization for purposes of the IITA.

For purposes of applying the 80% gross income test, examples of income from characteristic services are the following:

- application and origination fees, points, interest, late payment fees, and other charges received in connection with loans or with commitments to make loans or provide other credits
- service charges and early withdrawal or other penalties received in connection with deposit accounts
- loan servicing fees and charges received in connection with syndicated loans or loans sold to third parties
- discounts and gains realized on the purchase or resale of loans

Like banks, examples of items that ARE NOT considered income from characteristic services of a savings and loan association include rental income from real estate, gains from the sale of property obtained in foreclosure or settlement of loans, and income earned from securities (interest, dividends, and gains).

See IAC § 100.9710(d)(6) for more information.

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Back in the 1990s, the Legal Services Bureau advised the Audit Bureau that all audit activity should be terminated immediately and the audits cancelled on any cases involving savings and loan associations:

- For all years during which the savings and loan is in receivership under the control of the Resolution Trust Corporation (RTC) for the entire taxable year, or

- For any tax year which ends while the savings and loan is in receivership under the control of the RTC.

Due to federal statutes, Illinois is prohibited from assessing and/or collecting any tax from savings and loans in receivership under the control of the RTC in the two situations listed above.

Audits should continue on any cases in which an ENTIRE TAXABLE YEAR occurs prior to the entity going into receivership under the control of the RTC. The audit period should be limited, however, to this pre-receivership taxable year(s).

Assuming that the savings and loan association is no longer in receivership under the RTC, an audit should be pursuable.

7. Credit Union

Credit unions federally chartered under 12 USC 1754, incorporated under the Illinois Credit Union Act, or permitted to do business in Illinois, are most likely exempt from Illinois taxation. For federal and Illinois purposes, credit unions are meant to promote thrift and provide a source of credit for its members. The credit unions are required to invest their funds in loans to their members, bank accounts, government securities, and other credit unions. For purposes of the IITA, the determination of a credit union will be by its following characteristic services:

- taking interest-paying deposits from members
- making loans to members

For purposes of applying the 80% gross income test, examples of income from characteristic services are the following:

- application and origination fees, points, interest, late payment fees, and other charges received in connection with loans or with commitments to make loans or provide other credits

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- service charges and early withdrawal or other penalties received in connection with deposit accounts

Like banks, examples of items that ARE NOT considered income from characteristic services of a credit union include rental income from real estate, gains from the sale of property obtained in foreclosure or settlement of loans, and income from securities (interest, dividends, and gains).

See IAC § 100.9710(d)(7) for more information.

8. Currency Exchange

A currency exchange is licensed by the Director of Financial Institutions under the Currency Exchange Act (205 ILCS 405/4). Its primary functions are to cash checks, drafts, money orders or other money for consideration, and to issue/sell its own money orders. So, for purposes of the IITA, the following are the characteristic services of a currency exchange:

- cashing checks and other evidences of money for the general public
- issuing money orders

For purposes of applying the 80% gross income test, examples of income from characteristic services are the following:

- fees/charges for cashing checks
- fees/charges for issuing money orders

Interest or other income earned from the investment of funds received from cashing checks or issuing money orders IS NOT gross income from characteristic services.

See IAC § 100.9710(d)(8) for more information.

9. Small Loan Company

A small loan company is licensed by the Director of Financial Institutions under the Consumer Installment Loan Act (205 ILCS 670/1) to make loans in a principal amount not exceeding $40,000. While our regulation lists the loan threshold at $25,000, 205 ILCS 670/1 has since been amended and increased the principal loan maximum to $40,000. Further, the loan term is not to exceed 181 months. Our regulation lists the term limit as 121 months, but 205 ILCS 670/17 has since been amended and states the

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maximum term to be 181 months. For purposes of the IITA, the following is the characteristic service of a small loan company:

- Making loans not exceeding an aggregate principal amount of $40,000 to any obligor and for terms not exceeding 181 months

For purposes of applying the 80% gross income test, examples of income from characteristic services are the following:

- loan application and origination fees
- interest
- late payment charges
- other similar amounts realized in connection with loans

Note, any type of income received from a loan that exceeds the $40,000 principal and 181 month term IS NOT considered gross income from characteristic services. Neither is any income from loans made to business associations, corporations, or sole proprietors, for the purpose of carrying on or acquiring such businesses.

See IAC § 100.9710(d)(9) for more information.

10. Sales Finance Company

The criteria for classifying a company as a sales finance company is more detailed and involved than the other financial organizations. The following will provide explanations of the two ways a company can statutorily qualify as a sales finance company, including some examples. Then, reference will be made of the characteristic services and the 50% gross income test. An important difference between a sales finance company and other financial organizations is that only greater than 50% of its income has to come from characteristic services, not 80%.

a) Sales Finance Company Definition- IITA § 1501(a)(8)(C)(i)

IITA § 1501(a)(8)(C)(i) describes four types of companies that will be treated as sales finance companies. The four types of companies are commonly referred to as “credit”, “funding”, “loaning”, and “finance leasing” companies.

In order to qualify as a sales finance company under IITA § 1501(a)(8)(C)(i), a person (i.e. an individual, trust, estate, partnership, association, firm, company, corporation, limited liability, or fiduciary) must be PRIMARILY ENGAGED (greater

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than 50% of gross income averaged over three years) in one or more of the following businesses:

1. PURCHASING customer receivables (defined below). The person may purchase the customer receivables from the original seller in the transaction or from a person who purchased the customer receivable (directly or indirectly) from the original seller. The person may purchase the customer receivables from either a related or unrelated party. This type of an entity is referred to as a "credit" company.

   For example, the parent company (P) sells its accounts receivables at a discount to its subsidiary (S). The only business activity for S is the purchase of accounts receivable from P. S (a "credit" company) qualifies as a sales finance company.

2. Making loans SECURED BY customer receivables. The person may make the loan to the original seller in the transaction or to a person who purchased the customer receivable (directly or indirectly) from the original seller. This type of an entity is referred to as a "funding" company.

   For example, the parent company (P), a retailer, sells its accounts receivable from credit card operations at a discount to its subsidiary (Sub #1). The only business activity for Sub #1 is the purchase of accounts receivable from P. Sub #2's only business activity is to loan money to Sub #1 to purchase the accounts receivable. All of the loans made by Sub #2 are secured by the customer receivables that Sub #1 purchased from P. Sub #1 (a "credit" company) and Sub #2 (a "funding" company) qualify as sales finance companies.

3. Making loans for the express purpose of FUNDING PURCHASES OF TANGIBLE PERSONAL PROPERTY OR SERVICES by the borrower. This type of an entity is referred to as a "loaning" company.

   For example, the parent company (P), a large manufacturing company borrows money from its subsidiary (S). The only business activity for S is to make loans to P for the express purpose of purchasing tangible personal property or services. S (a "loaning" company) qualifies as a sales finance company.

   <u>Example #1</u>

   Subsidiary (S) has entered into a loan agreement with its parent (P). The loan agreement provides that S will loan money to P for capital expenditures and operating capital. The proceeds from the loan can be used to pay taxes, advertising, interest expense on third party loans, purchases of intangible

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property or real property, and other purposes beyond the purchase of tangible personal property or services. These expenditures do **not** involve the purchase of tangible personal property or services by the borrower. Consequently, loans made by S to P pursuant to the loan agreement cannot be said to be for the **"express purpose of funding purchases of tangible personal property or services".** S's only income is the interest income it receives from its loan to P. S does not qualify as a financial organization because its loan to P is not for the express purpose of funding purchases of tangible personal property or services.

4. FINANCE LEASING. A lease is a finance lease if the lessee is treated as the owner of the asset and allowed a depreciation deduction under the IRC. This type of entity is referred to as a "finance leasing" company.

   In contrast, a company engaged in the business of true leasing does NOT qualify as a sales finance company. A lease is considered a true lease if the lessor is treated as the owner of the asset and allowed a depreciation deduction under the IRC.

   For example, the parent company (P) sells some machinery to its subsidiary (S). The only business activity for S is to lease the equipment to third parties. All of S's leases are treated as finance leases under the IRC. S (a "finance leasing" company) qualifies as a sales finance company.

The PRIMARY TEST (greater than 50% gross income test) established by IITA § 1501(a)(8)(C)(i) will be used when a taxpayer is engaged in one or more qualifying businesses ("credit", "funding", "loaning" and "finance leasing") as well as other non-qualifying businesses.

IITA § 1501(a)(8) allows a person that is a "credit", "funding", "loaning", or "finance leasing" company to combine all of those activities to determine if the person qualifies as a sales finance company under IITA § 1501(a)(8)(C)(i). The statute does NOT however, allow a person to combine these activities with the activities of a company defined in IITA § 1501(a)(8)(C)(ii) to qualify as a sales finance company, as discussed below.

For purposes of IITA § 1501(a)(8)(C)(i), the term "customer receivable" means one of the following four items:

- a retail installment contract or retail charge agreement under the Sales Finance Agency Act, the Retail Installment Sales Act, or the Motor Vehicle Retail Installment Sales Act

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- an installment, charge, or similar contract or agreement from the sale of tangible personal property or services involving a deferred payment price payable in one or more installments

- the outstanding balance of a contract or agreement described in either of the previous bulleted items

- a loan, or its outstanding balance, made by a lender for the express purpose to fund purchases of tangible personal property or services by the borrower

The customer receivable does not have to require interest to be paid on the deferred payments. Further, the sales finance company can purchase the customer receivable or secure a loan with it from the original seller/lender or the purchaser of the receivable from the original seller/lender.

b) Sales Finance Company Definition – IITA § 1501(a)(8)(C)(ii)

IITA § 1501(a)(8)(C)(ii) describes a fifth type of company that qualifies as a sales finance company.

In order to qualify as a sales finance company under IITA § 1501(a)(8)(C)(ii), a corporation must meet ALL of the following requirements:

1. The corporation must be a member of an affiliated group.

The term “affiliated group” means the federal consolidated group, plus any corporation that would be a member of the federal consolidated group if not for IRC § 1504(b). IRC § 1504(b) excludes the following types of companies from a federal consolidated return:

- Exempt corporations under IRC § 501;
- Insurance companies subject to tax under IRC § 801;

- Foreign corporations;

- Corporations that have made an election under IRC § 936;

- Regulated investment companies and real estate investment trusts subject to tax under subchapter M of chapter 1 of the IRC; and

- Domestic International Sales Corporations (DISC).

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Therefore, if any of the above entities meet the other requirements to be included in the federal consolidated return (i.e. stock ownership), IRC § 1504(b) will be ignored and they will be considered to be a member of the affiliated group for purposes of the sales finance company definition.

2. The corporation must receive more than 50% of its gross income as interest income from qualifying loans.

Loans must meet the following requirements to be considered "qualifying loans":

A. The loan must be made to a member of the corporation's affiliated group that:

- originates customer receivables, or
- to whom customer receivables originated by another member of the affiliated group have been transferred.

B. The outstanding balance of all loans made by the corporation to members of its affiliated group CANNOT exceed the average outstanding balances during the taxable year of customer receivables (as defined above for IITA § 1501(a)(8)(C)(i)) originated by all members of the affiliated group. This is commonly referred to as the "limitation amount".

If the average outstanding balances of all loans made by the person to members of its affiliated group EXCEED the limitation amount described above, a portion of the interest income will be considered to be received from non-qualifying loans. The interest income from qualifying loans will be determined by multiplying the total interest income received on all loans to members of its affiliated group by a fraction, the numerator of which is the limitation amount and the denominator of which is the average outstanding balances of all loans made to members of the affiliated group.

<u>Example #2</u>
The parent corporation (P) has a subsidiary (S) that is attempting to qualify as a sales finance company under IITA § 1501(a)(8)(C)(ii). S received $400,000 of interest income from loans to members of the affiliated group. The average outstanding balances during the taxable year of customer receivables originated by all members of the affiliated group (the limitation amount) were $4,000,000. The average outstanding balances of all loans made to members of the affiliated group were $5,000,000. The interest income from qualifying loans is $320,000 ($400,000) X ($4,000,000/$5,000,000)).

3. The corporation must meet both of the following public funding requirements:

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A. The corporation's total shareholder's equity (including paid-in capital on common and preferred stock and retained earnings), plus the total of all of its loans, advances, and other obligations payable or owed to member(s) of its affiliated group is less than or equal to 20% of the corporation's total assets at any time during the year.

Example #3

The parent corporation (P) has a subsidiary (S) that is attempting to qualify as a sales finance company under IITA § 1501(a)(8)(C)(ii). The total stockholder's equity, loans from other members of the affiliated group, and total assets for S are $50 million, $250 million, and $2.0 billion respectively. The total of S's stockholder's equity and loans from other members of the affiliated group is only 15.0% of its total assets (($50 million + $250 million)/$2.0 billion). Since the stockholder's equity plus the loans from other members of the affiliated group divided by the total assets for S is less than 20%, it meets the public funding requirement of IITA § 1501(a)(8)(C)(ii)(c).

C. More than 50% of all of the interest-bearing obligations of the entire affiliated group payable to persons (i.e. an individual, trust, estate, partnership, association, firm, company, corporation, limited liability company, or fiduciary) outside of the affiliated group must be obligations of the corporation.

Example #4

The parent corporation (P) is a large retailing corporation. Sub #1 is attempting to qualify as a sales finance company under IITA § 1501(a)(8)(C)(ii). P's affiliated group has total interest bearing obligations to unrelated third parties of $1 billion. Further analysis of the interest bearing obligations of the affiliated group shows that P, Sub #1, Sub #2, and Sub #3 have interest bearing obligations of $275 million, $600 million, $75 million, and $50 million respectively. Sub #1 has 60% ($600 million/$1 billion) of the interest bearing obligations of the affiliated group. Since Sub #1 has more than 50% of the interest bearing obligations of the affiliated group, it meets the public funding requirement of IITA § 1501(a)(8)(C)(ii)(d). These calculations are summarized in the table below.

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	P	Sub 1	Sub 2	Sub 3
Interest Bearing Securities	275,000,000	600,000,000	75,000,000	50,000,000
Total Interest Bearing Securities	1,000,000,000	1,000,000,000	1,000,000,000	1,000,000,000
Percentage	27.5	60	7.5	5

IITA § 1501(a)(8)(C)(ii) MAY allow captive companies that loan money to other members of its affiliated group BASED on customer receivable balances, but not actually SECURED BY the customer receivables, to qualify as sales finance companies. However, it would appear that the public funding requirements contained in IITA § 1501(a)(8)(C)(ii)(c) and (d) will be very difficult for most captive companies to meet.

See IAC § 100.9710(d)(10) for more information.

11. Investment Company

The business of an investment company comes within the meaning of 15 USC § 80a-3. An investment company is predominantly engaged in investing, reinvesting, and trading in securities. For purposes of the IITA, the following are the characteristics of an investment company:

- Raising capital from investors
- Purchasing capital securities of other entities

For purposes of applying the 80% gross income test, examples of income from characteristic services are the following:

- Interest
- Dividends
- Gains from sales of securities

See IAC § 100.9710(d)(11) for more information.

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12. Bank Holding Company

An entity that qualifies as a “bank holding company” is considered a financial organization for Illinois apportionment purposes. Qualifying as a bank holding company is different than most of the other companies considered financial organizations, in that there is no 80%/50% gross income test. A “bank holding company” is an entity that, directly or indirectly, controls or has the power to vote 25% or more of any class of voting securities of any bank or any other bank holding company, and is registered with the Federal Reserve System under the Bank Holding Company Act of 1956 (12 USC § 1844(a)).

In other words, any company that has the 25% voting ownership of a bank or bank holding company and is registered with the Federal Reserve will be treated as a financial organization for apportionment purposes, and all of its subsidiaries will be treated as financial organizations under IAC § 100.9710(g), discussed in the next section.

On January 6, 1992, Sunshine Letter IT 92-02 was issued which stated that an institution (in this case a Credit Card bank) which is owned by a bank or bank holding company but which is not considered a "bank" under the Bank Holding Company Act of 1956 would not be considered a financial organization under IITA § 1508(a)(8). On June 29, 1992, Sunshine Letter IT 92-137 was issued which reversed that position.

See IAC § 100.9710(f) for more information.

13. Person Owned by Bank or Bank Holding Company

Another exception to the 80%/50% gross income test is for any entity owned by a bank or bank holding company. The definition of a financial organization which is contained in the IITA includes any person owned by a bank or bank holding company which the bank holding company is allowed to hold, directly or indirectly, under the provisions of the Bank Holding Company Act of 1956. An exception is made where the bank holding company must dispose of its interests in the person within certain required time limits set by the Bank Holding Company Act of 1956. Therefore, any entity which is PROPERLY held by a bank or bank holding company is a financial institution. The entity being held does not, in itself, have to qualify as a "bank" under the Bank Holding Company Act of 1956.

For example, an insurance company that is owned by a bank is considered a financial organization for apportionment purposes. The fact that the insurance company would be treated as an insurance company under IITA § 304(b) if it were not owned by the

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bank is irrelevant. For the period owned by the bank (or bank holding company), it is to be treated as a financial organization.

A "person" that a bank or bank holding company can own is a partnership. In that case, the partnership is treated as a financial organization for apportionment purposes, and if unitary, subject to the unitary partnership apportionment rules under IAC § 100.3380(d). For example, if a bank or bank holding company is a partner in a partnership that provides financial services that would normally apportion under IITA § 304(a), that partnership is deemed a financial organization for purposes of apportionment.

See IAC § 100.9710(g) for more information.

D. APPORTIONMENT FORMULA- TYE ON OR AFTER 12/31/08

All financial organizations are required to apportion their income under IITA § 304(c).

PA 95-233 and 95-707 added and modified paragraph (3), which provided a new apportionment formula for TYE on or after 12/31/08. Apportionment for financial organizations can be categorized as "TYE pre-12/31/08" and "TYE on/after 12/31/08". Taxable years ending before 12/31/08 are governed under IITA § 304(c)(1), and guidance is provided in IAC § 100.3400. Many of those provisions rely upon cost-of-performance for allocating receipts. Taxable years ending on/after 12/31/08 are governed under IITA § 304(c)(3), which shifted emphasis to a marketplace approach for allocating receipts, and guidance is provided in IAC § 100.3405.

PA 100-22 in 2017 modified the unitary business group (UBG) definition in IITA § 1501(a)(27)(B). It repealed the noncombination rule and expanded the definition of "United States" to include the outer continental shelf (OCS) for taxable years ending on or after December 31, 2017. For applicable years going forward, auditors will include financial organizations in the same UBG as companies that apportion under IITA § 304(a), (b), etc. Basically, each apportionment subgroup (e.g. financial organizations) will determine their total sales under IITA § 304(a), and then determine their traditional factor (e.g. IITA § 304(c)) and multiply that percentage by the member's total sales to calculate Illinois sales. A new schedule and instructions have been created to help calculate the factor in this situation: Subgroup Schedule (UB). Refer to this schedule and instructions under "Forms" on the Department's website for more information. Click on the following link to take you to the current processing year's corporate forms:

https://www2.illinois.gov/rev/forms/incometax/Pages/currentyear/business-corporate.aspx

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IITA § 304(c)(3) states in part:

> For taxable years ending on or after December 31, 2008, the business income of a financial organization shall be apportioned to this State by multiplying such income by a fraction, the numerator of which is its gross receipts from sources in this State or otherwise attributable to this State's marketplace and the denominator of which is its gross receipts everywhere during the taxable year.

The following will provide a discussion of apportioning the different types of income listed under IITA § 304(c)(3) for TYE on/after 12/31/08, starting with the factor denominator and then numerator.

1. Application of IITA § 304(c)(3) - Denominator

The denominator of the apportionment formula SHOULD include ALL items of business income which are included in base income. The denominator of the apportionment formula should NOT include any item of income that was EXCLUDED from base income or that was SUBTRACTED in the computation of base income. Consequently, the following items should not be included in the apportionment formula:

- Dividends federally deducted through dividends received deduction under IRC § 243
- U.S. Government interest allowed as a subtraction modification by IITA § 203(b)(2)((J)
- Interest on loans made by the taxpayer to a borrower that are secured by property which is eligible for the Enterprise Zone Investment Credit (prior to 8/7/12) /River Edge Redevelopment Zone as allowed under IITA § 203(b)(2)(M)
- Interest on loans made by the taxpayer to a borrower that are secured by property which is eligible for the High Impact Business Investment Credit under IITA § 203(b)(2)(M-1)
- Dividends that qualify for the foreign source dividend subtraction under IITA § 203(b)(2)(O)
- Any items properly classified as nonbusiness income

In determining the amount of business income included in the numerator or the denominator of the apportionment formula, amounts of business income received during the tax year SHALL NOT be reduced by any expenses allocable to the business.

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In determining the amount of a gain or loss to be included in the apportionment factor, you should take into account the basis in the property sold or otherwise disposed of. In other words, you should only include the net gain or loss in the apportionment factor. In no event shall a loss included in business income reduce the numerator or denominator of the apportionment factor below zero.

Further, when dealing with gains from investment and trading activities, only net gains (NOT net losses) are to be included in the receipts factor and determined for each transaction. This is different than pre-TYE 12/31/08 treatment, which allowed losses to reduce gains to zero. To illustrate, let's say stock A was traded for a net gain of $50,000, and stock B was traded for a net loss of $(100,000), both sourced to Illinois. In TYE 12/07, stock B would have been taken into account and offset the net gain of stock A to zero, so that $0 would have been in the factor. However, in TYE 12/08, the net loss of stock B is disregarded. Only the $50,000 net gain would be reported in the Illinois numerator and denominator.

2. Application of IITA § 304(c)(3) - Numerator

In calculating the numerator of the apportionment formula, each item of business income included in base income must be sourced based on the provisions of IITA § 304(c)(3). Income items included in the numerator are not to be reduced by related expenses. The auditor should identify each item of business income included in base income which is described in IITA § 304(c)(3)(i) through (viii). Those items should then be sourced to Illinois based on the rules, which are discussed below, applicable to IITA § 304(c)(3)(i) through (viii). All other items of business income included in base income will be sourced to Illinois under IAC § 100.3405(c)(9). Finally, the adjusted income of an International Banking Facility as described in IITA § 304(c)(2), if any, will be excluded from the Illinois numerator.

Some other items, such as "interest", are defined in IAC § 100.3400, and are applicable to apportionment for TYE on/after 12/31/08. See the section *Apportionment Formula – TYE BEFORE 12/31/08* for those definitions.

a) Definitions

"Fixed place of business" has the same meaning as in IRC § 864 and related Treasury regulations (IITA § 1501(a)(9.5)). This is further clarified regarding the Treasury regulations found under 26 CFR § 1.864-7(b) and (d), and these points can be summarized as follows:

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- Generally, it will be a fixed facility through which the taxpayer engages in its trade or business. (See 26 CFR § 1.864-7(b)(1).)
- Merely using another person's place of business sporadically or infrequently does not qualify that place as the taxpayer's fixed place of business. (See 26 CFR § 1.864-7(b)(2).)
- An agent's fixed place of business is not a fixed place of business of the taxpayer unless the agent has the authority to negotiate and conclude contracts on behalf of the taxpayer, regularly exercises the authority, and is not an independent agent. (See 26 CFR § 1.864-7(d)(1)(i).)
- An independent agent's fixed place of business cannot be treated as the taxpayer's fixed place of business. (See 26 CFR § 1.864-7(d)(2).)
- For these purposes, an "independent agent" means a general commission agent, broker, or other agent of independent status acting in the ordinary course of his/her business. (See 26 CFR § 1.864-7(d)(3).)

See IAC § 100.3405(b)(1).

"Gross receipts" is defined in IITA § 304(c)(3) as "gross income, including net taxable gain on disposition of assets, including securities and money market instruments, when derived from transactions and activities in the regular course of the financial organization's trade or business." IAC § 100.3405(b)(2).

Unless a financial organization (taxpayer) has actual knowledge to the contrary, the "state of residence" and "commercial domicile" of a person (customer) are deemed to be the state in the person's billing address. IAC § 100.3405(b)(3).

Lastly, "substantive contacts" regarding an investment asset or trading activity means the research, approval, and administration activities involved with the investment or trading, conducted by the taxpayer's employees in its fixed place of business. IAC § 100.3405(b)(4).

See IAC § 100.3405(b) for more details.

b) Lease and Rental Receipts

Receipts from lease/rental of real or tangible personal property are sourced to Illinois if the property is located in Illinois during the rental period. If the property is characteristically moving property (e.g. vehicles, rolling stock, aircraft, vessels, mobile equipment), the receipts allocable to Illinois will be based upon the use in Illinois. A ratio should be calculated comparing the use/time in Illinois divided by the use/time everywhere.

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Example #5

Taxpayer rented office space from a building it owns in the Chicago Loop. Since the real property is located in Illinois, the rental income is sourced to Illinois.

Example #6

Taxpayer received total lease income of $25,000,000 from leasing construction equipment, which is used 55% of the time in Illinois, and 45% in other neighboring states. That would result in $13,750,000 (.55 x $25,000,000) being sourced to Illinois.

See IAC § 100.3405(c)(1).

c) Receipts from Loans Secured by Real or Tangible Personal Property (TPP)

"Receipts" from these loans include interest income, commissions, fees, gains on disposition, and other related income.

Income received from loans secured by real property/TPP is sourced to Illinois if the security (real property/TPP) is located in Illinois. For TPP, the property is in this state if the debtor is an Illinois resident or has its commercial domicile in Illinois when the loan is made.

When a loan is secured by property located in and outside of Illinois, the receipts are allocated to Illinois based upon the ratio of property located in Illinois to property everywhere, as of the time the loan was made.

Example #7

Taxpayer made a commercial loan to an excavation corporation secured by the equipment purchased from the proceeds. The excavation corporation has its commercial domicile in Illinois. Thus, the security is deemed to be in Illinois and the interest income, fees, and other receipts from the commercial loan are sourced to Illinois.

See IAC § 100.3405(c)(2).

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d) Receipts from Consumer Loans NOT Secured by Real or Tangible Personal Property

"Receipts" from these loans include interest income, commissions, fees, gains on disposition, and other related income.

These receipts are sourced to Illinois if the debtor is an Illinois resident.

Example #8

Taxpayer is a small bank domiciled in Illinois, with branches in Illinois, Missouri, Kentucky, and Indiana. A Missouri resident is approved for a personal loan in an Illinois branch. The income associated with the personal loan would not be sourced to Illinois, since the debtor is not an Illinois resident.

See IAC § 100.3405(c)(3).

e) Receipts from Commercial Loans/Installment Obligations NOT Secured by Real or Tangible Personal Property

"Receipts" from these loans include interest income, commissions, fees, gains on disposition, and other related income.

These receipts are sourced to Illinois if the proceeds from the loan are to be applied in Illinois. If it cannot be determined where the proceeds are applied, then the receipts can be sourced to Illinois if the borrower's office from where the loan was negotiated is located in Illinois. If the location of this office cannot be determined, receipts should be EXCLUDED from both the numerator and denominator of the factor. This is the first throw-out provision for financial organizations apportioning under IITA § 304(c)(3). The second throw-out provision applies to performance of services.

Example #9

Taxpayer is a Midwest commercial bank, operating in Illinois and multiple states. Borrower is a partnership that conducts a multistate business, with its commercial domicile in Illinois and other offices throughout the Midwest. Borrower obtains a commercial loan from taxpayer, negotiated in Illinois, that is secured by funds in one of its business demand accounts. The proceeds are used to provide additional working capital, and used to aid in paying vendors in different regions. It is not possible to identify where the proceeds are specifically applied. Since the loan was

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negotiated from an office in Illinois, taxpayer should source all income associated with the commercial loan to Illinois.

See IAC § 100.3405(c)(4).

f) Receipts from Credit Card Receivables

"Receipts" from the credit card receivables include interest income, fees, gains on disposition, service charges, merchant discount income, and other related income.

These receipts are sourced to Illinois if the card charges are regularly billed to a customer in Illinois.

Example #10

Taxpayer is a multistate bank and credit card company with Illinois nexus. Receipts from credit card receivables of $600,000,000 are earned from customers who are billed at Illinois addresses. The $600,000,000 should be sourced to Illinois.

See IAC § 100.3405(c)(5).

g) Receipts from the Performance of Services

"Receipts from the performance of services" include income from fiduciary, advisory, and brokerage services. The actual statutory language in IITA § 304(c)(3)(vi) says the following:

> (vi) Receipts from the performance of services, including, but not limited to, fiduciary, advisory, and brokerage services, are in this State if the services are received in this State within the meaning of subparagraph (a)(3)(C-5)(iv) of this Section.

Any service a financial organization performs can be sourced under this provision. While it explicitly lists "fiduciary, advisory, and brokerage services", it expressly does not limit the services to those three items. For example, a bank may receive fees for cashing checks. Check cashing fees would be a "performance of services" and sourced under IITA § 304(c)(3)(vi). Once, a bank under audit had provided its customers expedited tax return refunds subcontracted through a tax preparer for a fee, but argued that the fees could not be sourced under this provision because the fees did not fit under one of the illustrative examples of "fiduciary, advisory, or brokerage services." (and instead should be sourced like money orders). Audit took the position that the statute expressly does not limit "performance of services" to those three items. Certain fees for providing assisted tax preparation and expedited refunds were determined to be receipts for performing a service.

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Receipts for performing services are sourced to Illinois if the services are "received in Illinois" as defined in IITA § 304(a)(3)(c-5)(iv). This means that financial services are sourced to Illinois in the same manner as the sale of services are for companies that apportion under IITA § 304(a).

Under IITA § 304(a)(3)(c-5)(iv), gross receipts from sales of services are generally assigned to the numerator and denominator of the Illinois sales factor if the services are received in Illinois. However, in the case of services provided to a corporation, partnership, or trust, gross receipts from services received in Illinois are not included in the numerator of the Illinois sales factor unless the corporation, partnership, or trust maintains a fixed place of business in Illinois. In addition, gross receipts from services received outside of Illinois may be deemed received in Illinois, and thus included in the numerator of the Illinois sales factor, if the recipient corporation, partnership, or trust does not maintain a fixed place of business in the state in which the services are actually received and either (i) the customer ordered the services in the regular course of business from its Illinois office, or (ii) if the ordering office cannot be determined, the services are billed to the customer's Illinois office. Finally, where a taxpayer is not taxable in the state in which the services are actually or deemed received, the associated gross receipts must be EXCLUDED from both the numerator and denominator of the Illinois sales factor. This is the second scenario in which financial organizations have a throw-out provision under IITA § 304(c)(3), by applying the throw-out rule for sales of services.

If services are performed for an individual and the subject matter of the service may not be identified as an item of tangible personal property, real property, or the individual's person, then the service is deemed to be received in the individual's state of residence. In such circumstances, if the services are provided to an Illinois resident, then the gross receipts would be assigned to Illinois. Unless the taxpayer has actual knowledge that the residence of an individual is different from the billing address of the individual at the time of the sale, the individual is deemed to be a resident of the state in which the billing address is located.

Example #11

Taxpayer is a Midwest regional bank that also provides financial advisory services to its customers. Customer is a small corporation headquartered in Illinois that received advisory services in the St. Louis, Missouri, branch of the bank. Customer does not have a fixed place of business in Missouri, and the charges for these services are billed in Illinois. The taxpayer should source the fees from advisory services to Illinois.

See IAC § 100.3405(c)(6).

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h) Receipts from Issuing Travelers Checks/Money Orders

"Receipts" from issuing these negotiable instruments would generally be the fees charged to customers for purchase.
The receipts are sourced to Illinois if the checks or money orders are issued from a location in Illinois.

Example #12

Taxpayer owns a multistate currency exchange business. All fees earned from money orders issued from Illinois stores should be sourced to Illinois.

See IAC § 100.3405(c)(7).

i) Receipts from Investment Assets/Activities and Trading Assets/Activities

The sourcing of receipts from investment and trading assets/activities is more detailed than the previous types of receipts. IITA § 304(c)(3)(viii) governs how these receipts are to be sourced, and IAC § 100.3405(c)(8) essentially restates the statute. The auditor should refer to these provisions. The following will just highlight a few points.

"Receipts" from investment and trading assets/activities include interest, net gains (not less than zero), and other related income. This means a net loss is disregarded for investment and trading and does not reduce net gains to zero. These assets/activities include investment securities, trading account assets, federal funds, securities purchased and sold under agreements to resell or repurchase, options, futures contracts, forward contracts, notional principal contracts such as swaps, equities, and foreign currency transactions.

The receipts can be divided into three groups:

- investment activities and assets
- interest from federal funds sold and purchased, securities purchased under resale agreements, and securities sold under repurchase agreements
- trading assets and activities

NOTE: In the tradition of the old financial organization apportionment statute (IITA § 304(c)(1)), the language in the new statute (IITA § 304(c)(3)) requires the computation of a fraction that is totally unnecessary. The old provision said that the business income apportioned to the state equaled the total items of business income from Illinois sources divided by total business income from all sources, which meant

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that all the auditor really had to do was add up the Illinois sourced business income. The same thing is true here. All the auditor really needs to do is add up the gross income from assets assigned to Illinois. See Example 13 for further clarification.

Each group of these receipts is separately examined and assigned to Illinois by multiplying the total of each by a fraction, the numerator being receipts assignable to a fixed place of business in Illinois, and the denominator being the gross income from all such receipts (from each group).

An investment is assigned to the fixed place of business with which it has a "preponderance of substantive contacts". "Substantive contacts" are the research, approval, and administration activities involved with the investment or trading, conducted by the taxpayer's employees in its fixed place of business. Illinois *presumes* that the investment and trading is properly assigned if the following three things occur:

- *the taxpayer has assigned, in the regular course of its business, such asset or activity on its records to a fixed place of business consistent with federal or state regulatory requirements;* (IITA § 304(c)(3)(viii)(2)(D)(1))
- *such assignment on its records is based upon substantive contacts of the asset or activity to such fixed place of business;* and (IITA § 304(c)(3)(viii)(2)(D)(2))
- *the taxpayer uses such records reflecting assignment of such assets or activities for the filing of all state and local tax returns for which an assignment of such assets or activities to a fixed place of business is required.* (IITA § 304(c)(3)(viii)(2)(D)(3))

The Department can rebut with a preponderance of evidence the presumption of proper assignment by showing that the preponderance of substantive contacts did not occur at the fixed place of business where assigned by the taxpayer. If the presumption of proper assignment does not apply or has been rebutted, the asset or activity should be sourced to the state of commercial domicile. The commercial domicile is presumed to be the U. S. state or Washington D. C. where the greatest number of employees are regularly connected with the management of the investment or trading income or out of which they are working, regardless of where they perform their services, as of the last day of the taxable year.

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Example #13

Taxpayer is a large multistate investment bank that, among other activities, conducts investment and trading activities and respective assets. It has offices in major cities throughout the world, including Chicago, with its headquarters in New York City. Gross receipts from its trading assets and activities total $1 billion. None of those receipts have substantive contacts with Illinois. Gross receipts from its investment assets and activities total $550 million. Of that, $150 million in dividends and $200 million in interest have a preponderance of substantive contacts with the Chicago office.

This means that $350 million ($150 dividends and $200 interest) from the investment assets and activities should be sourced to Illinois and included in the numerator. None of the income from trading assets or activities would be sourced to Illinois, and $1.55 billion ($1 billion + $550 million) would be included in the denominator.

Note: No computation of fractions was necessary. Receipts that have a preponderance of substantive contacts with a fixed place of business in Illinois should be sourced to Illinois and included in the numerator, while the total gross receipts from all such activities would be included in the denominator.

j) All Other Receipts

All other receipts that are includable in apportionment factor denominator and do not fall under sections (b) through (i) above should be sourced to Illinois if they are considered “sales in this State” under the provisions of IITA § 304(a)(3) and IAC §§ 100.3370 and 100.3380. The “greater than 50% of gross receipts” requirement for income from certain intangibles under IITA § 304(a)(3)(B-2) is to be disregarded.

Example #14

Taxpayer is a multistate financial organization that operates as a large retail and commercial bank. Taxpayer offers many products and services to its retail customers, including different kinds of checking and money-market demand accounts. Certain fees, such as monthly service fees, returned item fees, overdraft fees, account research fees, and stop payment fees are common charges to account customers. Income from these fees would be sourced to Illinois according to IITA § 304(a)(3), specifically IITA § 304(a)(3)(c-5)(iv) for TYE on or after 12/31/08.

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E. APPORTIONMENT FORMULA - TYE BEFORE 12/31/08

For TYE prior to 12/31/08, financial organizations apportion business income and source receipts to Illinois by following IITA § 304(c)(1) and IAC § 100.3400. IITA § 304(c)(1) states, in part:

> In general. For taxable years ending before December 31, 2008, business income of a financial organization shall be apportioned to this State by multiplying such income by a fraction, the numerator of which is its business income from sources within this State, and the denominator of which is its business income from all sources.

The following will provide a discussion of apportionment and sourcing the different types of income listed under IITA § 304(c)(1) for TYE prior to 12/31/08, starting with the factor denominator and then numerator.

1. Application of IITA § 304(c) - Denominator

The denominator of the apportionment formula SHOULD include ALL items of business income which are included in base income. The denominator of the apportionment formula should NOT include any item of income that was EXCLUDED from base income or that was SUBTRACTED in the computation of base income. Consequently, the following items should not be included in the apportionment formula:

- Dividends federally deducted through dividends received deduction under IRC § 243
- U.S. Government interest allowed as a subtraction modification by IITA § 203(b)(2)((J)
- Interest on loans made by the taxpayer to a borrower that are secured by property which is eligible for the Enterprise Zone Investment Credit (prior to 8/7/12) /River Edge Redevelopment Zone as allowed under IITA § 203(b)(2)(M)
- Interest on loans made by the taxpayer to a borrower that are secured by property which is eligible for the High Impact Business Investment Credit under IITA § 203(b)(2)(M-1)
- Dividends that qualify for the foreign source dividend subtraction under IITA § 203(b)(2)(O)

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- Any items properly classified as nonbusiness income

In determining the amount of business income included in the numerator or the denominator of the apportionment formula, amounts of business income received during the tax year shall not be reduced by any expenses allocable to the business.

In determining the amount of a gain or loss to be included in the apportionment factor, you should take into account the basis in the property sold or otherwise disposed of. In other words, you should only include the net gain or loss in the apportionment factor. In no event shall a loss included in business income reduce the numerator of the apportionment factor below zero.

2. Application of IITA § 304(c) - Numerator

In calculating the numerator of the apportionment formula, each item of business income included in base income must be sourced based on the provisions of IITA §304(c)(1). Income items included in the numerator are not to be reduced by related expenses. The auditor should identify each item of business income included in base income which is described in IITA § 304(c)(1)(A) through (D). Those items should then be sourced to Illinois based on the rules, which are discussed below, applicable to IITA § 304(c)(1)(A) through (D). All other items of business income included in base income will be sourced to Illinois under IITA § 304(c)(1)(E). Finally, the adjusted income of an International Banking Facility as described in IITA § 304(c)(2), if any, will be excluded from the Illinois numerator.

a) Definitions

Until the adoption of IAC § 100.3400 on June 20, 2002, IITA § 304(c)(1) contained several terms that are NOT defined in the IITA or any relevant authority. The terms discussed below have been defined in IAC § 100.3400.

For federal income tax purposes, the United States Supreme Court has defined "interest" to mean "compensation for the use or forbearance of money." (*Deputy v. du Pont*, 308 U.S. 488, 498 (1940)). Pursuant to IITA § 102, this definition of the term "interest" for purposes of the IRC also applies to the term "interest" as used in the IITA. (REF: Sunshine Letter 98-0007-PLR).

- Interest includes the amortization of any discount at which an obligation is purchased and is net of the amortization of any premium at which an obligation is purchased.

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- Interest includes any amount received upon the sale, exchange or other disposition of an obligation to the extent that such amount represents the accrual of interest on the unpaid balance of the obligation since the most recent payment made on that obligation.

- Interest does not include late payment penalties that are in addition to interest expressly charged on any past-due balance or that are computed without regard to the amount of the past-due balance or the length of time a payment is late.

"Gross profits from trading in stocks, bonds, or other securities" of a financial organization means the net gain or net loss realized on the sale, exchange or other disposition of a security other than a security representing an interest in or obligation of that financial organization (i.e. the financial organization's common stock or a debt obligation of the financial organization itself). In addition, "gross profits from trading in stocks, bonds, or other securities" also includes any net gain or loss realized on the sale, exchange or other disposition of a financial organization's interest in a loan or other indebtedness of a customer of the financial organization payable to the financial organization. "Gross profits from trading in stocks, bonds or other securities" does NOT include any amount that is properly characterized as a fee or commission earned by the financial organization or any dividends or interest earned by the financial organization.

"Dividend" means any item defined as a dividend under 26 USC § 316 (IRC § 316) and includes any other item of income characterized or treated as a dividend under the Internal Revenue Code.

"Margin account" means any extension of credit made by a financial organization for the purchase or carrying of securities by the borrower, within the meaning of 15 USC § 78g.

"Stocks, bonds or other securities" means any share of stock in any corporation, certificate of stock, or interest in any corporation, note, bond, debenture, or other evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing within the meaning of 26 USC § 1236(c).

"Fees, commissions or other compensation for financial services" means all items of income, other than interest, dividends and gross profit from trading in stocks, bonds or other securities, paid to a financial organization by its customers for the provision of those services characteristic of financial organizations, as defined in IAC § 100.9710. This includes the following:

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- late payment fees or penalties to the extent not properly classified as interest
- penalties for early withdrawal of deposits or early repayment of debt
- loan origination fees, charges for credit investigations, filing fees, etc. to the extent they are not properly characterized as interest

The term "customer" will include a person for whom a financial organization provides financial services directly or through an agent or other fiduciary of the financial organization. Some examples of this definition are shown below:

- A bank participates in a syndicated loan. The borrower is a customer of the bank if the bank is a named party to the original transaction for whom the lead bank is acting as an agent. If a bank purchases a participation in an existing loan, the borrower is not a customer of the bank because the bank is not providing a financial service to the borrower.
- When a financial organization finances the accounts receivable of a business, the obligor on the account is a customer of the financial organization only if the financial organization purchases the receivable, thus creating a direct relationship between itself and the obligor.
    - If a financial organization makes a loan to a company secured by the company's customer receivables, the company is the customer of that financial organization but the company's customers are not customers of the financial organization because the loan is a financial service provided to the company rather than to the company's customers.
    - If a financial organization purchases a customer account receivable from a company, the company's customer thereby becomes a customer of the financial organization.

The term “Illinois customer” has the following meaning:

- A customer who is an Illinois resident individual, trust, or estate; or
- A customer other than an individual, trust or estate whose commercial domicile is in Illinois.

Unless a financial organization has actual knowledge that the residence or commercial domicile of a customer during a taxable year is in a state other than the state in which the customer’s billing address is located, the customer shall be deemed to be an

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Illinois customer if the billing address of the customer, as shown in the records of the financial organization relating to the interest income being sourced, is located in Illinois and shall be deemed not to be an Illinois customer if that billing address is located outside Illinois.

See IAC § 100.3400(b) for more details.

b) Fees, Commissions or Other Compensation for Financial Services

The Illinois numerator of a financial organization includes fees, commissions, or other compensation treated as business income and included in base income from financial services rendered within Illinois

In order for fees, commissions or other compensation received by a financial organization to be included in the Illinois numerator of the apportionment formula, the financial services MUST have been rendered in Illinois. Financial services are rendered in Illinois if:

- The income-producing activity is performed in Illinois; or
- The income-producing activity is performed both within and without Illinois and a greater proportion of the income-producing activity is performed within Illinois than without Illinois, based on performance costs.

If the performance costs of two or more income-producing activities cannot readily be allocated among those activities, the gross income resulting from those activities shall be combined and sourced to Illinois using the combined performance costs for all those activities.

Example #15

A bank received $250,000 in gross receipts from late payment fees, penalties for early withdrawal of deposits, and loan origination fees. All of the financial services relating to these gross receipts were performed in Illinois.

The gross receipts of $250,000 from these items should be included in both the numerator and denominator of the apportionment formula.

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c) Gross Profits from Trading

The Illinois numerator of a financial organization includes gross profits from trading stocks, bonds or other securities treated as business income and included in base income which are managed within Illinois.

Gross profits from trading in stocks, bonds, or other securities means the net gain (loss) realized on the sale, exchange, or other disposition of a security. It would also include any gain (loss) realized on the sale, exchange, or other disposition of a financial organization's interest in a loan or other indebtedness of a customer of the financial organization payable to the financial organization. Losses are only included, however, to the extent that they offset gains from trading.

Gross profits from trading in stocks, bonds, or other securities do not include dividends and interest which are sourced under different subsections of IITA § 304(c)(1). It also does not include a security representing an interest in or obligation of the financial obligation such as a gain (loss) realized from purchasing a bond previously issued by the financial organization.

The trading of stocks, bonds, or other securities is managed within Illinois if:

- The income-producing activity is performed in Illinois; or
- The income-producing activity is performed both within and without Illinois and a greater proportion of the income-producing activity is performed within Illinois than without Illinois, based on performance costs.

If the performance costs of two or more income-producing activities cannot readily be allocated among those activities, the gross income resulting from those activities shall be combined and sourced to Illinois using the combined performance costs for all those activities.

The costs associated with the acquisition, ownership, and disposition of a security would include a portion of the salaries and related expense of the employee(s) who make the decisions to acquire or dispose of the securities, recordkeeping and other clerical costs, the costs of supervision of employees involved in these functions, and any other indirect costs properly allocable to these functions.

Example #16

A financial organization had gross receipts of $100,000 from the sale of common stock. The taxpayer's basis in the common stock was $75,000 so it reported a capital

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gain of $25,000 on its federal Form 1120 return. All of the costs associated with the acquisition, ownership, and disposition of the common stock were in Illinois.

The gross profit of $25,000 should be included in both the numerator and denominator of the apportionment formula.

d) Dividends and Interest

IAC § 100.3400(c)(3) contains the rules for sourcing all dividends included in business income of a financial organization and all interest (other than interest on margin accounts) received by a financial organization.

The Illinois denominator of a financial organization will include all dividends included in business income of a financial organization and all interest income (other than interest on margin accounts) received by a financial organization.

The Illinois numerator of a financial organization will include dividends, and interest from Illinois customers, which are received in this state, treated as business income, and included in base income. Interest will never be sourced to Illinois unless it is received from an Illinois customer.

Interest from an Illinois customer or dividends are "received in this state" if the payment comes within the control of the financial organization or of an agent or other fiduciary of the financial organization at a location within Illinois. One is said to act in a "fiduciary capacity", when the business which he transacts, or the money or property which he handles, is not his own or for his own benefit, but for the benefit of another person, as to whom he stands in a relation implying and necessitating great confidence and trust on the one part and a high degree of good faith on the other part.

If payment of an item of interest income that has been accrued and included in base income for a tax year is not received prior to the date the return for that tax year is filed, the financial organization shall treat the payment as received at the location to which the borrower is directed to send the payment or, if no single location is specified, at the location at which the financial organization reasonably expects to receive the interest.

A payment will be considered "received in this State" if the payment is sent to a lockbox located in Illinois or the electronic funds transfer from the customer is directed to a bank located in Illinois. (REF: Sunshine Letter 98-0007- PLR).

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For example, a financial organization headquartered in Illinois instructs its customers to mail all payments to a lock box located in St. Louis. Since the checks came within the control of the financial organization's agent when they were received at the lock box in St. Louis, they are considered to be received outside of Illinois. Whether the lock box is serviced by the financial organization's own employees or by a company acting as agent for the financial organization is irrelevant, because receipt by either an employee or an agent of the financial organization will give it control. The checks would be considered as received outside of Illinois even if they were subsequently deposited at a bank located in Illinois.

An electronic funds transfer is received by a financial organization at the location of the bank carrying the account of the financial organization into which the funds are deposited. The following examples will illustrate where an electronic funds transfer will be considered to be received for purposes of IITA § 304(c)(1)(C):

- A bank with branches in Illinois and Missouri maintains a Federal Reserve Bank account at the Federal Reserve Bank of St. Louis. Any electronic funds transfer deposited into the bank's Federal Reserve Bank account at the Federal Reserve Bank of St. Louis will be received OUTSIDE of Illinois.

- A financial organization maintains an account at the Illinois branch of a bank with branches in both Illinois and Missouri. The financial organization's bank maintains a Federal Reserve Bank account at the Federal Reserve Bank of St. Louis. If the bank receives a payment on behalf of the financial organization and subsequently credits the payment to the financial organization's account in Illinois, the payment will be considered to be received IN Illinois. The payment is not within the control of the financial organization until such time as it is deposited into the financial organization's account. The deposit of funds into the account of the bank at the Federal Reserve Bank does not place the funds within the control of the financial organization because the bank, merely by participating in the electronic transfer, is not acting as collection agent for the financial organization.

Investment interest received by a financial organization will be included in the denominator of the apportionment formula but will never be included in the numerator of the apportionment formula because it is not received from an Illinois customer.

Example #17

An Illinois bank has an investment committee that makes all of its investment decisions. After the committee reaches an investment decision, the securities are purchased and/or sold at the bank's brokerage firm located in New York. The

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dividends earned on the investments are credited to the bank's brokerage account in New York.

The dividends are received OUTSIDE of Illinois and to the extent they are treated as business income and included in base income will ONLY be included in the denominator of the apportionment formula.

Example #18

A unitary group of banks solicits, originates, and closes mortgage loans, commercial loans and installment loans inside and outside of Illinois. The loans are made to Illinois and non-Illinois customers. In 1992, the banks set up a centralized loan processing center in St. Louis, Missouri. All aspects of servicing the loans such as cash collections, management of escrow accounts, monitoring past due accounts, loan documentation, and posting to books and records are performed in St. Louis. The banks' remittance instructions to the loan customers indicate that payments are to be mailed to the centralized processing facility in St. Louis; however, a few payments are received and accepted at one of the banks' Illinois facilities and then forwarded to the centralized processing facility in St. Louis. All of the checks are deposited at a bank facility located in Missouri and credited to the respective affiliate's bank account held at the Missouri bank.

All of the interest which is received at the centralized processing facility in St. Louis, treated as business income, and included in base income will be included ONLY in the denominator of the apportionment factor because it is RECEIVED outside of Illinois. All of the interest received at one of the bank's Illinois facilities from Illinois customers, treated as business income, and included in base income WILL BE included in the Illinois numerator of the apportionment formula.

Example #19

A financial organization received dividends of $100,000 on some common stock. The financial organization reported the dividends of $100,000 and claimed a dividend exclusion of $70,000 on its federal Form 1120. The dividends were received in Illinois.

The $30,000 of gross receipts included in Illinois base income will be included in the denominator of the apportionment formula.

Example #20

A financial organization received $50,000 of interest on loans that were made to a taxpayer who has successfully claimed the Investment Credit for qualified property

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placed in service in an Enterprise Zone (IITA § 201(f)). The loans were secured by property relative to which the IITA § 201(f) Investment Credit was claimed. On its Form IL-1120, the taxpayer claimed a subtraction modification under IITA § 203(b)(2)(M) for $50,000.

Since none of the interest is included in Illinois base income, none of the interest income will be included in either the numerator or denominator of the apportionment factor.

Example #21

A financial organization reported $200,000 of municipal interest on Line 7 of federal Schedule M-1. Further analysis showed that this consisted of $210,000 of gross receipts from municipal interest and $10,000 of amortized premium. On its Form IL-1120, the taxpayer reported an addition modification of $210,000 for municipal interest and an "other" subtraction modification of $10,000 for amortized premium. The municipal interest was received in Illinois.

The financial organization should include $200,000 in the denominator. The $200,000 of municipal interest would be investment interest and would never be included in the Illinois numerator.

The *Continental* case (*Continental Illinois National Bank and Trust Co. of Chicago v. Lenckos*, 102 Ill. 2d 210 (1984)), supports the Department's position that only $200,000 should be included in the denominator of the apportionment factor. In reaching its decision, the *Continental* Court cited another case which stated that, "In presenting its 1942 tax proposals, however, the Treasury adopted the view that each receipt of interest is not entirely income but is partially a restoration of capital."

Based on this reasoning, although Illinois treats the amortization as a deduction and the federal tax return treats it as a deduction, it is actually an adjustment to the total amount of income received to reflect only interest in the tax base. Therefore, the gross amount of interest received should be reduced by the amount of the amortized premium and only the net amount included in the apportionment factor.

Example #22

A financial organization has gross receipts from U.S. Government interest of $520,000. The taxpayer had amortized premium of $20,000 and reported a subtraction modification for U.S. Government interest of $500,000 on its Form IL-1120. The U.S. Government interest was received in Illinois.

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Since U.S. Government interest is not included in Illinois base income, the taxpayer should not include any receipts from U.S. Government interest in the apportionment formula (REF: *Continental Illinois National Bank and Trust Co. of Chicago v. Lenckos*, 102 Ill. 2d 210 (1984)).

Example #23

A bank is commercially domiciled in Peoria, Illinois. The bank has no locations outside of Peoria, Illinois. Its investment portfolio is managed by an investment committee consisting of officers and directors of the bank. The bank has received interest of $10,000,000 from its investment portfolio. All of the interest was received in Illinois and is included in Illinois base income. The bank would include $10,000,000 in the denominator of the apportionment formula and $0 in the numerator of the apportionment formula.

Example #24

A financial organization with its corporate headquarters in San Francisco, California, received interest income from obligations issued by the Federal National Mortgage Association of $305,000. The taxpayer had amortized premium of $5,000 relating to these obligations. The interest income from these obligations was received at a branch office in Illinois.

Based on the *Continental* decision, the gross amount of the interest received should be reduced by the amount of the amortized premium and only the net amount included in the apportionment formula. Therefore, the taxpayer should include $300,000 in the denominator and $0 in the numerator of the apportionment formula.

Example #25

A financial organization located in Springfield, Illinois, loans money to a corporation commercially domiciled in Missouri to build a plant in Springfield, Illinois. The financial organization receives $100,000 of interest at its location in Springfield, Illinois from the corporation. The financial organization should include $100,000 in the denominator of the apportionment formula and $0 in the numerator of the apportionment formula. Since its commercial domicile is located in Missouri, the corporation is NOT an Illinois customer.

Example #26

A credit card bank purchases its cardholders' balances from a retailer pursuant to an agreement under which the retailer services the accounts. Payments are received by

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the credit card bank at the location where the retailer receives the payments on its behalf, not at the location to which the retailer forwards the payments.

Example #27

A bank makes a loan to an Illinois customer secured by the customer's accounts receivable. Pursuant to the loan agreement, the bank's customer directs its customers to send their payments to the bank, which deposits the payments in an account at its Chicago branch in the name of the customer, from which the bank may withdraw loan payments to itself. The funds in the customer's account are not within the control of the bank. Payments withdrawn by the bank from the account at the Chicago branch pursuant to the agreement are received in Illinois regardless of where the payments from the customers are received by the bank. However, if the customer pays the bank by check drawn on the account at the Chicago branch, payment is received by the bank in the state in which it receives the check.

Example #28

A financial organization acts as a primary dealer in U.S. Government securities and as an underwriter and dealer in U.S. Government agency securities. Due to the nature of the taxpayer's business (i.e. the taxpayer enters into a large number of arbitrage transactions to neutralize the effect of interest rate fluctuations), the taxpayer's transactions generate large amounts of interest income and corresponding interest expense. An examination of the taxpayer's books and records showed the following information:

- The taxpayer received interest income of $5,000,000 and had corresponding interest expense of $4,975,000 from U.S. Government securities.

- The taxpayer received interest income of $4,000,000 and had corresponding interest expense of $3,985,000 from U.S. Government Agency securities that do not qualify for a subtraction modification on the taxpayer's Form IL- 1120.

- The taxpayer had gross receipts from the sale of both U.S. Government and U.S. Government Agency securities to third party customers totaling $700,000,000. The taxpayer's adjusted basis in these securities was $697,000,000 so it reported a capital gain of $3,000,000 on its federal Form 1120.

- All of the costs associated with the acquisition, ownership, and disposition of these securities is in Illinois.

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- The interest from these securities was received in Illinois.

Since none of the gross receipts from the interest on U.S. Government securities are included in Illinois base income, none of these receipts should be included in the apportionment formula. The taxpayer should include the $4,000,000 of interest income from U.S. Government Agencies and the $3,000,000 capital gain in the denominator of the apportionment factor. The taxpayer should include only the $3,000,000 capital gain in the numerator of the apportionment factor.

e) Interest on Margin Accounts

The Illinois numerator of a financial organization will include interest charged to customers at places of business maintained within this state for carrying debit balances of margin accounts, without deduction of any costs incurred in carrying such accounts. The interest must be treated as business income and included in base income to be included in the apportionment factor.

Interest earned on a margin account by a financial organization is sourced to Illinois if the financial organization's place of business through which the borrower ordinarily conducts business with the financial organization is located in Illinois.

Example #29

A financial organization earns interest of $10,000 for carrying a debit balance on a margin account. The margin account was maintained at a place of business in Illinois.

The financial organization should include $10,000 in both the numerator and denominator of the apportionment formula. The entire $10,000 will be included in the factor without any deduction for costs incurred in carrying such accounts.

f) Any Other Gross Income from Operations

The Illinois numerator of a financial organization includes any other gross income treated as business income and included in base income resulting from the operation as a financial organization within this state. This subsection will apply to all items of business income included in base income that are NOT sourced under IITA § 304(c)(1)(A) through 304(c)(1)(D). In order for any other gross income received by a financial organization to be included in the Illinois numerator of the apportionment formula, the costs of performance of the operations producing such income MUST be incurred in Illinois.

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Gross income that results from the operation of a taxpayer as a financial organization "within this State" is allocable to Illinois if:

- The income-producing activity is performed in Illinois; or
- The income-producing activity is performed both within and without Illinois and a greater proportion of the income-producing activity is performed within Illinois than without Illinois, based on performance costs.

If the performance costs of two or more income-producing activities cannot readily be allocated among those activities, the gross income resulting from those activities shall be combined and sourced to Illinois using the combined performance costs for all those activities.

Example #30

A bank owns a subsidiary that writes credit life insurance. The subsidiary is properly owned under the Bank Holding Company Act of 1956 and qualifies as a financial organization under IITA § 1501(a)(8). The subsidiary received $1,000,000 of gross receipts from writing credit life insurance. The costs of performance of the operations producing this income were within Illinois.

The bank should include $1,000,000 in both the numerator and denominator of the apportionment formula.

Example #31

The taxpayer has a net gain of $5,000 on the sale of office equipment previously used in its business at its branch office in St. Louis, Missouri. The taxpayer's corporate headquarters is in Illinois. The gross receipts from the sale of the office equipment were $100,000.

The taxpayer should include $100,000 in the denominator of the apportionment factor.

F. SUBTRACTION MODIFICATIONS UNIQUE TO FINANCIAL ORGANIZATIONS

Generally, the same addition and subtraction modifications that apply to other companies apply to financial organizations. See Audit Manual Chapters 24 and 25 for further information on base income modifications. There are three subtraction modifications that

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are unique to financial organizations, which will be discussed in this section. They are the following:

- Subtraction Modification for Enterprise Zone and River Edge Redevelopment Zone Interest
- Subtraction Modification for High Impact Business Interest
- Subtraction Modification for Federally Disallowed Deductions

A few comments are also included about the repeal of the noncombination rule for taxable years on or after December 31, 2017, and its impact on financial organizations and the related-party transaction modifications.

1. Enterprise Zone and River Edge Redevelopment Zone Interest

In general, IITA § 203(b)(2)(M) allows taxpayers who are financial organizations to subtract the interest income received from loans that are secured by property that qualifies for the enterprise zone investment or river edge redevelopment zone investment credits under IITA § 201(f). The interest income must have been included in its federal taxable income. Public Act 97-905 amended IITA § 203(b)(2)(M) by eliminating references to enterprise zones effective August 7, 2012. The subtraction will continue to apply to interest from qualified investments in river edge redevelopment zones.

It is necessary to determine whether the property securing the loan is “eligible property”, the portion of the loan that is secured by eligible property, and the basis of the eligible property.

For information on how to calculate the subtraction modification and examples, refer to IAC § 100.2655.

Example #32

Taxpayer A is a commercial bank that loaned $1,000,000 to Borrower B. The loan is secured by eligible property under IITA § 201(f) with a basis of $1,300,000 when put into service. Taxpayer A received $80,000 in interest income during TYE 12/10 regarding the loan to Borrower B. Taxpayer A would be allowed a subtraction modification for the full $80,000 under IITA § 203(b)(2)(M).

2. High Impact Business Interest

In general, IITA § 203(b)(2)(M-1) allows taxpayers who are financial organizations to subtract the interest income received from loans that are secured by property that

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qualifies for the High Impact Business Investment Credit under IITA § 201(h). The taxpayer cannot claim this subtraction modification if it is also eligible to subtract the interest under IITA § 203(b)(2)(M). The interest income must have been included in its federal taxable income. It is necessary to determine whether the property securing the loan is "eligible property", the portion of the loan that is secured by eligible property, and the basis of the eligible property.

For information on how to calculate the subtraction modification and examples, refer to IAC § 100.2657.

Example #33

Taxpayer A is a commercial bank that loaned $1,000,000 to Borrower B. The loan is secured by eligible property under IITA § 201(h) with a basis of $800,000 when put into service, and $500,000 of ineligible property. Taxpayer A received $80,000 in interest income during TYE 12/13 regarding the loan to Borrower B. Taxpayer A would be allowed a subtraction modification of $64,000 under IITA § 203(b)(2)(M-1). That amount is based upon calculating the portion of the loan secured by eligible property, and then multiplying that ratio times the interest income related to the loan secured by the eligible property. The ratio would be $800,000/$1,000,000, or simply .8. That ratio times the interest income from the related loan equals the subtraction modification of $64,000 (.8 x $80,000).

3. Expense Deductions Disallowed Federally

Taxpayers are allowed to take a subtraction modification for certain expenses that are disallowed as deductions federally. This is authorized in IITA § 203(b)(2)(I), and our regulations provide further detail in IAC § 100.2455.

Two of these subtractions are related specifically to financial organizations. The IRC disallows interest expense deductions that are related to carrying tax-exempt obligations, and created special rules for "financial institutions". These rules fall under IRC §§ 291(a)(3), (e)(1)(B), and 265(b); "financial institutions" are persons whose business involves accepting deposits from the public and are subject to state or federal regulations as a financial institution. Essentially, such companies would be banks and treated as financial organizations for Illinois purposes.

The following excerpt from an IRS TAM # 200434029 (TAM-154001-03) issued on March 26, 2004, provides a good explanation of the IRC provisions:

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Section 291(a)(3) reduces by 20 percent the amount allowable as a deduction with respect to any "financial institution preference item." Pursuant to § 291(e)(1)(B), a financial institution preference item is the portion of a financial institution's interest expense that is allocable to tax-exempt obligations acquired after December 31, 1982, and before August 8, 1986. This portion is the amount that bears the same ratio to the taxpayer's interest expense as the taxpayer's average adjusted bases of these tax-exempt obligations bears to the taxpayer's average adjusted bases of all its assets. Section 291(e)(1)(B) applies to any financial institution that is a bank as defined in § 585(a)(2).

Section 265(b)(1) disallows entirely the portion of a financial institution's interest expense that is allocable to tax-exempt interest. Pursuant to § 265(b)(2), this portion is the amount that bears the same ratio to the taxpayer's interest expense as the taxpayer's average adjusted bases of tax-exempt obligations acquired after August 7, 1986, bears to the taxpayer's average adjusted bases of all its assets. Section 265(b)(5) defines the term "financial institution" to mean any person that (a) accepts deposits from the public in the ordinary course of that person's trade or business and is subject to federal or state supervision as a financial institution, or (b) is a corporation described in § 585(a)(2).

Section 265(b)(3) provides a special rule for "qualified tax-exempt obligations," as defined in § 265(b)(3)(B). Any qualified tax-exempt obligation that is acquired after August 7, 1986, is treated for purposes of §§ 265(b)(2) and 291(e)(1)(B) as if it were acquired on August 7, 1986. Thus, qualified tax-exempt obligations result in the disallowance of interest expense deductions under § 291(a)(3) and (e)(1)(B), rather than § 265(b).

Legislative purpose of § 291(a)(3) and (e)(1)(B) and § 265(b)

Congress enacted § 291(a)(3) and (e)(1)(B) in 1982 and § 265(b) in 1986. Before the enactment of these sections, a financial institution's investment in tax-exempt obligations generally did not result in any disallowance of interest expense deductions. Although § 265(a)(2) (formerly § 265(2)) disallows deductions for interest on indebtedness incurred to purchase or carry tax-exempt obligations, this section requires evidence of a direct connection between the borrowing and the tax-exempt investment. In effect, this requirement virtually exempts financial institutions from disallowance of interest deductions under § 265(a)(2).

To correct this problem, Congress first enacted § 291(a)(3) and (e)(1)(B), which restricts the interest expense deductions of financial institutions without requiring evidence of connection between borrowing and tax-exempt investment. Unlike

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§ 265(a)(2), § 291(a)(3) and (e)(1)(B) applies to all of a financial institution's otherwise deductible interest expense and provides for a pro rata disallowance of interest expense deductions on the basis of the institution's holdings in tax-exempt obligations. Section 265(b) strengthens the disallowance rule of § 291(a)(3) and (e)(1)(B) by increasing from 20 percent to 100 percent the disallowance of interest expense deductions allocable to tax-exempt obligations acquired after August 7, 1986. The purpose and structure of § 265(b) are essentially the same as those of § 291(a)(3) and (e)(1)(B), and § 265(b) applies to any financial institution to which § 291(a)(3) and (e)(1)(B) applies.

A bank whose federal income tax deduction for interest expense has been limited under either provision is allowed to subtract the disallowed interest expense on the Illinois return, as stated in IAC §100.2455(c) & (e). The taxpayer should be expected to provide adequate documentation of the federally disallowed items to support the amount of the Illinois subtraction modification.

4. Related-Party Transactions for Noncombination Companies for Taxable Years Ending on or after December 31, 2017

Due to changes from PA 100-22, effective July 6, 2017, the noncombination rule found in IITA § 1501(a)(27)(B) does not apply for taxable years ending on or after 12/31/17. This means the related-party transaction modifications no longer apply to noncombination companies for taxable years ending on or after 12/31/17. For corporations, these modifications are found under IITA § 203(b)(2)(E-12), (E-13), and E-14) and the reversal subtraction modifications under IITA § 203(b)(2)(V), (W), (X), and (Y).

Starting with tax years ending on or after December 31, 2008 PA 95-233 and PA 95-707 expanded the use of Schedule 80/20 to require addition modifications for interest expenses, intangible expenses and insurance premium expenses paid to a person who would have been a member of a unitary business group but for the noncombination rule in IITA § 1501(a)(27). In addition, the public acts eliminated the previous requirement that the affiliate be an 80/20 company.

The noncombination related-party modifications can apply to companies with captive financial organizations for taxable years ending on or after 12/31/08 and before 12/31/17. The Illinois Schedule 80/20 was amended starting in 2008 along with IAC § 100.2430. For TYE on or after 12/31/17, the modifications are no longer necessary, because companies that apportion under different subsections of IITA § 304 can be part of the same UBG. Any related-party transactions are subject to federal consolidation and intercompany elimination rules. In other words, Illinois no longer needs to correct

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for tax distortions that occur when unitary companies are part of separate UBGs. The 2017 Illinois Schedule 80/20 reflects these changes, as only 80/20 companies are allowed the modifications and noncombination companies are not included on the form.

To illustrate these changes, let us consider a related-party transaction regarding a captive sales finance company in TYE 12/31/14 versus TYE 12/31/17:

Example #34

In TYE 12/31/14, a unitary group composed of manufacturers ("M") pays $10 million in interest to one of its unitary subsidiaries located in Wisconsin ("SFC") that qualifies as a sales finance company under IITA § 1501(a)(8)(C)(i) and apportions its income under IITA § 304(c). SFC is excluded from M's Illinois UBG under the noncombination rule. M pays SFC interest for loans to purchase tangible business property, which reduces M's federal taxable income. M is subject to an addition modification under IITA § 203(b)(2)(E-12) and will report the $10 million in interest payments on its Schedule 80/20. If SFC is an Illinois filer, it will be allowed to report a subtraction modification of $10 million under IITA § 203(b)(2)(V).

Example #35

Same facts as previous Example #34, except M pays SFC $10 million in interest payments during TYE 12/31/17. Since the noncombination rule no longer applies, M and SFC will be part of the same UBG and the noncombination modifications for the $10 million of interest no longer apply. The $10 million intercompany interest transactions will be eliminated for federal and Illinois purposes, having a zero tax effect for federal taxable income and Illinois base income. For more information on the related-party transaction modifications, see Audit Manual Chapters 24 and 25.

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INSURANCE COMPANIES

Revised 10/19

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I. PURPOSE

Illinois statutes require an insurance company to apportion its business income by using the special apportionment formula described in IITA § 304(b).

An audit of an insurance company requires some specialized auditing skills. The federal income tax returns filed by insurance companies are among the most complex federal income tax returns filed. The information provided in this Chapter should assist the auditor in auditing an insurance company and reduce the time required to acquire the specialized knowledge needed to audit an insurance company.

This Chapter contains the following:

- a definition of an insurance company;
- a description of the two basic types of ownership for an insurance company;
- a description of the types of federal returns that are filed by insurance companies;
- a description of the various categories of insurance companies, such as casualty, life, reinsurance, mutual, surplus line company, captive insurance company, health maintenance organizations, and risk retention groups;
- discussions of the Life and Health Insurance Guarantee Association income tax offsets,
- deductions claimed under IRC § 847, IRC § 1503(c) limitations;
- nonbusiness income for insurance companies, holding companies of insurance companies;
- the Annual Statements filed by insurance companies; and
- two insurance company questionnaires.

II. REFERENCE SOURCES

The following is a general list of sources regarding insurance companies. Other and more specific references are made throughout the Chapter. This list is by no means exhaustive:

- IITA § 304(b)
- IAC § 100.3420
- IRC § 801 through 848
- 2008 Official NAIC Annual Statement Blank – Life
- 2008 Official NAIC Annual Statement Blank – Property and Casualty
- IRS Audit Technique Guide, Excise Tax- Foreign Insurance
- Schedule UB/INS

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III. GENERAL INFORMATION

Insurance companies are in the business of making legal and enforceable contracts between one party (the insurer or underwriter) and another (the insured). In exchange for receiving a premium from the insured, the insurer agrees to pay a predetermined amount of money to the insured if and when the insured suffers a loss described in the insurance contract (the insurance policy).

The examination of an insurance company differs from other types of taxpayers. Taxable income is not controlled entirely by gross receipts and expenditures. The taxable income of an insurance company depends upon the total of investment and underwriting income. A life insurance company's taxable income may include distributions from the policyholders' surplus account. The computations of these amounts are somewhat complex.

Unlike examinations of manufacturing and commercial type corporations, almost all of the verification and reconciliation of income and expense items of insurance companies can be made with the use of the Annual Statement. These financial statements are verified and audited by the insurance commission examiners of the states in which the insurance company does business. The Annual Statement is a standard form adopted by the National Association of Insurance Commissioners (NAIC) and should be used by the auditor in the same manner as the general ledger and subsidiary books of account of other industries.

A. DEFINITION OF AN INSURANCE COMPANY

Although the IITA does not define the term "insurance company," IITA § 102 states that unless otherwise provided any term used in the Act shall have the same meaning as when used in a comparable context in the Internal Revenue Code (IRC). Therefore, the term "insurance company" for Illinois income tax purposes means any taxpayer properly treated as an insurance company for federal income tax purposes under Subchapter L, IRC §§ 801 through 848. This definition was copied into IAC § 100.3420(b).

In most cases, it will be obvious whether or not a company should be treated as an insurance company. The issue whether a taxpayer is an insurance company typically arises when dealing with captive insurance companies, health maintenance organizations, and other questionable companies that may or may not meet the IRS definition discussed below.

IRC §§ 831(c) and 816(a) define "insurance company" to mean "any company more than half the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies." (26 U.S.C. § 816(a)) The definition provides only thresholds that must be surpassed in regard to the

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amount of insurance business that must be conducted in order for a company to be taxed as an insurance company. It does not define "insurance contract". To be an insurance company for federal income tax purposes, a taxpayer must issue *insurance contracts*, and the issuing of insurance contracts must comprise *more than half* of the taxpayer's business.

Any corporation that is PROPERLY treated as an insurance company for federal purposes MUST also be treated as an insurance company under the IITA and be required to apportion its income under IITA § 304(b).

B. TYPES OF OWNERSHIP FOR INSURANCE COMPANIES

There are two major types of ownership for insurance companies: stock and mutual companies.

Stock companies are owned by the common stockholders of the company. Through stock purchases, the stockholders provide capital to the company and the company earns a profit on that capital on behalf of the stockholders. The profits of a stock company are either paid out to the stockholders in the form of dividends or reinvested as retained earnings.

Mutual companies do not have any stockholders and are owned by their policyholders. The profits of a mutual company are distributed to the policyholders as policy dividends at the end of the year. There are several types of mutual companies. An assessment mutual is an insurance company in which policyholders may be assessed for losses beyond the ability of the company to cover. A legal reserve mutual is seen especially in the life insurance field. This type maintains a reserve against possible claims, so it is able to sell policies under which policyholders may not be assessed for losses. A factory mutual specializes in providing property insurance on high-grade industrial properties. Since it restricts the type of risks it will accept, it is usually able to charge lower rates than those charged by companies accepting average risks.

C. FEDERAL CLASSIFICATION OF INSURANCE COMPANIES

1. For Tax Years Ending After December 31, 1986

For tax years ending after December 31, 1986, insurance companies can be classified into two separate categories:

- Life insurance companies; and
- Non-life insurance companies.

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The 1986 changes had no effect on the return requirements to be filed by life insurance companies. Both stock and mutual life insurance companies are still required to file form federal Form 1120-L. In addition, IRC § 1504(c)(2) still allows certain life insurance companies to file a consolidated life/non-life return with the IRS.

All non-life insurance companies are now required to file form federal Form 1120-PC (US Property and Casualty Insurance Company Income Tax Return).

2. For Tax Years Ending On Or Before December 31, 1986

For years ending on or before December 31, 1986, the IRC classified insurance companies into three separate categories:

- Life insurance companies;
- Mutual insurance companies, other than life, marine, or certain fire insurance companies; and
- Other insurance companies, including mutual marine and certain mutual fire insurance companies.

Both stock and mutual life insurance companies were required to file form federal Form 1120-L. IRC § 1504(c)(2) provided an election whereby certain life insurance companies could be treated as includible corporations, and thus members, of a group composed of other includible non-life corporations. This section of the IRC allowed certain life insurance companies to file a consolidated life/non-life return with the IRS. This provision is effective for taxable years for which the due date (without extensions) for filing returns is after March 14, 1983.

Mutual insurance companies other than life, marine, or certain mutual fire or flood insurance companies were required to file form federal Form 1120M.

All other insurance companies were required to file federal Form 1120. Included in this category were mutual marine companies and certain mutual fire insurance companies. These companies were allowed to file a consolidated Form 1120 return with other includible corporations that were not insurance companies.

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D. OTHER STATES' TAXATION OF INSURANCE COMPANIES

There are many states that do not require insurance companies to file income tax returns. Generally, these states only require insurance companies to file a Privilege or Premiums Tax return.

E. ILLINOIS TAXATION OF INSURANCE COMPANIES

1. Nexus

Every insurance company that has nexus with Illinois is required to file an Illinois Income Tax return. Every foreign or alien insurance company conducting business in Illinois, except fraternal benefit societies, is also required to file an Illinois Privilege Tax and Retaliatory Statement with the Illinois Department of Insurance.

To tax a foreign insurance company (i.e., incorporated and domiciled outside of Illinois), the same U.S. Constitutional thresholds must be met as for any other foreign company. The Due Process clause requires that some minimum connection exist between the state and person, property, or transaction to be taxed. The higher threshold to be met falls under the Commerce Clause, which requires that the state's tax only be applied to an activity with "substantial nexus" to the taxing state. (*Quill Corp.* (1992))

If a foreign insurance company is insuring risk in Illinois, then a presumption of nexus is created. Previous guidance may have directed that insuring risk and the potential to investigate, settle, defend, and pay on claims alone create nexus. However, the mere "potential" does not pass the Due Process threshold, as was determined in the U.S. Supreme Court case of *State Board of Insurance v. Todd Shipyards Corporation,* 370 U.S. 451 (1962).

In that case, Texas tried to impose tax on insurance premiums paid to a foreign insurance company that carried on no activities other than having insured risk in Texas, as noted in the opinion:

> The insurance transactions involved in the present litigation take place entirely outside Texas. The insurance, which is principally insurance against loss or liability arising from damage to property, is negotiated and paid for outside Texas. The policies are issued outside Texas. All losses arising under the policies are adjusted and paid outside Texas. The insurers are not licensed to do business in Texas, have no office or place of business in Texas, do not solicit business in Texas, have no agents in Texas, and do not investigate risks or claims in Texas.

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The auditor should presume nexus with insured risk in Illinois, but if the taxpayer challenges this assertion, the auditor will need to investigate the activities of the foreign insurance company to determine whether the company has Illinois nexus or not. The activities that were lacking in *Todd Shipyards* (1962) can provide some general activities to consider, that if present, develop a case of Illinois nexus:

- Does the insurer investigate risks or claims in Illinois?
- Does the insurer have agents in Illinois?
- Does the insurer have an office or place of business in Illinois?
- Does the insurer solicit business in Illinois?
- Are losses paid or adjusted in Illinois?
- Are policies issued in Illinois?
- Is the insurance negotiated or paid in Illinois?
- Is the insurer licensed to do business in Illinois?
- Do any other insurance transactions take place in Illinois?

The more of these activities or items that are occurring in Illinois, the stronger the nexus position becomes. If none of the above items are present in Illinois, and the only Illinois activity is the insured risk in Illinois, then nexus would not be defendable. The above items were the principal insurance activities outlined in *Todd Shipyards* (1962) but are not an exhaustive list.

In 2015, a nexus questionnaire specific to insurance companies was developed and posted for auditors to use, the EDA-132-NI. It is currently available on the intranet under Work Areas > Audit > Forms > Income Tax. Below is the current link:

https://rev.portal.illinois.gov/Core/Forms/Documents/EDA-132-NI.pdf

The first part of the questionnaire deals with nexus questions for insurance companies, while the second part tailors the nexus questions to captive insurance companies. Since the auditor may only need to use some of the questions on the questionnaire, the auditor can copy those questions and incorporate them in an EDA-70 or other communication.

For more questions relating to both nexus and captive insurance companies, see the two unadopted questionnaires developed by auditors before the EDA-132-NI,later in this Chapter under the Exhibits section at QUESTIONNAIRE 1 and QUESTIONNAIRE 2.. These may give you some additional relevant questions or documents to consider outside the scope of the EDA-132-NI.

For more general nexus discussion, see Chapter 22.

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2. Illinois Privilege Tax

The Illinois Department of Insurance administers the Illinois Privilege Tax or Premium Tax as it is sometimes called. There is an interrelationship between the Illinois Income Tax Act and the Illinois Privilege Tax Act. When applicable, the Illinois Privilege Tax Act allows an insurance company to reduce on a dollar for dollar basis the amount of privilege tax due by the amount of Illinois Income and Replacement Tax paid during the year. In other words, an insurance company can receive a tax credit on their Illinois Privilege Tax return for the amount of Illinois Income and Replacement Tax paid during the year.

Insurance company representatives will often tell corporate income tax auditors that they will receive a credit for any Illinois Income Tax liability established against their Illinois Privilege Tax. This is irrelevant to the determination of the company's Illinois Income Tax liability.

Corporate income tax audits on insurance companies assigned to the field should be completed even if it appears to the auditor that the company will be entitled to a credit against their Illinois Privilege Tax for any additional income tax liability.

F. NONCOMBINATION RULE UPDATE

Effective July 6, 2017, PA 100-22 modified the unitary business group (UBG) definition in IITA § 1501(a)(27)(B). It repealed the noncombination rule and expanded the definition of "United States" to include the outer continental shelf (OCS) for taxable years ending on or after December 31, 2017. Insurance companies that apportion under IITA § 304(b) will combine with companies that apportion under other subsections of IITA § 304. This is a major adjustment to how auditors determine the UBG and combined apportionment, and eliminates the related-party expense modifications for noncombination companies for the applicable tax periods. For more information, see Audit Manual Chapters 23 for UBGs, 24 & 25 for modifications, and 27 for apportionment. Also see "Addition Modification for Related Party Insurance Reimbursement Subtraction Modification" and "Subtraction Modification for Related Party Insurance Premiums" sections in this chapter.

This means the related-party transaction modifications no longer apply to noncombination companies for taxable years ending on or after 12/31/17. For corporations, these modifications are found under IITA § 203(b)(2)(E-12), (E-13), and E-14) and the reversal subtraction modifications under IITA § 203(b)(2)(V), (W), (X), and (Y).

Starting with tax years ending on or after December 31, 2008 PA 95-233 and PA 95-707 expanded the use of Schedule 80/20 to require addition modifications for interest

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expenses, intangible expenses and insurance premium expenses paid to a person who would have been a member of a unitary business group but for the noncombination rule in IITA § 1501(a)(27). In addition, the public acts eliminated the previous requirement that the affiliate be an 80/20 company.

The noncombination related-party modifications can apply to companies with captive insurance company for taxable years ending on or after 12/31/08 and before 12/31/17. The Illinois Schedule 80/20 was amended starting in 2008 along with IAC § 100.2430. For TYE on or after 12/31/17, the modifications are no longer necessary, because companies that apportion under different subsections of IITA § 304 can be part of the same UBG. Any related-party transactions are subject to federal consolidation and intercompany elimination rules. In other words, Illinois no longer needs to correct for tax distortions that occur when unitary companies are part of separate UBGs. The 2017 Illinois Schedule 80/20 reflects these changes, as only 80/20 companies are allowed the modifications and noncombination companies are not included on the form.

To illustrate these changes, let us consider a related-party transaction regarding a captive insurance company in TYE 12/31/14 versus TYE 12/31/17:

Example A

In TYE 12/31/14, a unitary group composed of manufacturers ("M") pays $10 million in insurance premiums to its captive insurance company located in Wisconsin ("CI") that qualifies as an insurance company under IAC § 100.3420(b) and apportions its income under IITA § 304(b). CI is excluded from M's Illinois UBG under the noncombination rule. M pays CI insurance premiums for different lines of business insurance, which reduces M's federal taxable income. M is subject to an addition modification under IITA § 203(b)(2)(E-14) and will report the $10 million in insurance expense on its Schedule 80/20. If CI is an Illinois filer, it will be allowed to report a subtraction modification of $10 million under IITA § 203(b)(2)(V).

Example B

Same facts as previous Example A, except M pays CI $10 million in insurance premium payments during TYE 12/31/17. Since the noncombination rule no longer applies, M and CI will be part of the same UBG and the noncombination modifications for the $10 million of insurance premium expense no longer apply. The $10 million intercompany insurance transactions will be eliminated for federal and Illinois purposes, having a zero tax effect for federal taxable income and Illinois base income. For more information on the related-party transaction modifications, see Audit Manual Chapters 24 and 25.

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IV. APE SPECIFIC LAW APPLICATION

A. FEDERAL TAXABLE INCOME

1. Casualty Companies (Fire, Marine, And Auto)

For years ending after December 31, 1986, all casualty companies (stock and mutual) are required to file a federal Form 1120-PC return. Most casualty companies will calculate their federal insurance company taxable income (ICTI) using Schedule A of Form 1120-PC. The federal taxable income calculated on Schedule A is reported on line one of page one of the Form 1120-PC. This should be the figure reported on Line 1 of the IL-1120.

If a casualty company is a small company as defined by IRC § 831(b)(2), its taxable income may be computed in a different manner than used on Schedule A. They may make an election to be taxed on taxable investment income, and they will complete Schedule B of Form 1120-PC, instead of Schedule A. The federal taxable income calculated on Schedule B is reported on line two, page one of the Form 1120-PC. This should be the figure on Line 1 of the IL-1120. Once a company elects to be taxed on taxable investment income, it must continue to be taxed in the same manner (as long as it qualifies) unless the Secretary of the Treasury consents to the revocation of the election. REF: IRC § 831(b)(2).

One additional factor may have to be considered in the computation of Illinois ICTI (and life insurance company taxable income (LICTI)) for some companies that have filed federal consolidated returns for tax years ended after December 31, 1987. Under the IRC, insurance companies (property, casualty and life) are allowed a unique federal deduction for reserves accrued for covered losses which have been incurred by its policyholders, but which had not yet been paid. Some background is necessary to understand the impact on Illinois.

Prior to the Tax Reform Act of 1986, there was a problem with the way the companies were taking the deduction. They were accruing the total amount of estimated losses, even in cases where it was certain that the losses would not be paid until several years after the time of the deduction. Consequently, the IRS made revisions to IRC § 832(b)(5) to require them to deduct only the present value of unpaid losses per IRC § 846. Since the rules for phasing in this change were inequitable, the IRS added IRC § 847 to remedy the situation. (See the Glossary at INSURANCE COMPANY GLOSSARY for a more detailed explanation.) In essence, this new section permitted an insurance company that is required to discount the amount of unpaid losses, in computing its losses incurred deduction, to take an additional special deduction to

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account for that discounting. This deduction is allowable to the extent that the company establishes and maintains a special loss discount account, and makes special estimated tax payments with respect to the tax benefits the insurance company receives. The deduction is taken in the process of computing ICTI (and LICTI) for the federal return. For property and casualty companies, refer to the "Additional Deduction" line of Schedule A of the Form 1120-PC. The corresponding "Special Estimated Tax Payment" is found on Page 1 of the Form 1120-PC.

Generally, this deduction will not have to be examined by the Illinois auditor except in some cases where a federal consolidated return is filed. In preparing their federal consolidated return, an insurance company may choose to show the IRC § 847 deduction as either one consolidating adjustment or as a deduction on the separate company income statement for each of the insurance companies entitled to the deduction. Some confusion has resulted in past Illinois audits when a consolidated group chooses to take the deduction as one consolidating adjustment for federal purposes, and not all the members of the group file together in Illinois.

Regardless of which way the company elects to take the deduction, they ARE ENTITLED to take the applicable amount of the deduction for each individual Illinois filer in the computation of separate company taxable income. IITA § 203(e)(2)(E) supports this procedure:

In the case of a corporation which is a member of an affiliated group of corporations filing a consolidated income tax return for the taxable year for federal income tax purposes, taxable income is determined as if such corporation had filed a separate return for federal income tax purposes for the taxable year and each preceding taxable year for which it was a member of an affiliated group.

For more detailed information on the federal method of computing ICTI for non-life insurance companies, refer to IRC §§ 831 and 832.

For the years ending on or before December 31, 1986, casualty companies other than some mutual insurance companies filed regular federal Forms 1120. They were not subject to the special federal provisions provided for life and mutual insurance companies. Casualty companies were allowed to file consolidated federal 1120 returns with other corporations that were not in the insurance business. Consequently, federal taxable income for casualty companies for years on or before December 31, 1986 is obtained from page one of the federal Form 1120 return.

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2. Life Insurance Companies

The federal computation of Life Insurance Company Taxable Income (LICTI) has undergone some substantial changes over the years. Despite the changes at the federal level, one pivotal date applies to Illinois – September 1, 1989, when Public Act 86-678 was passed. In general, IITA § 203(e)(2)(A) contains Illinois's rule for determining LICTI.

a) Tax Years Ending on or after September 1, 1989 to Current

IITA § 203(e)(2)(A) was amended with the passing of **Public Act 86-678 on September 1, 1989**. The IITA was corrected to read:

> Taxable income properly reportable for federal income tax purposes shall mean:…in the case of a life insurance company subject to the tax imposed by Section 801 of the Internal Revenue Code, life insurance company taxable income, plus the amount of distribution from pre-1984 policyholder surplus accounts as calculated under Section 815(a) of the Internal Revenue Code.

Consequently, for tax years ending on or after September 1, 1989, LICTI for Illinois purposes is NOT the total taxable income figure on the federal Form 1120-L. Instead, it equals LICTI for federal purposes increased by distributions to shareholders from pre-84 policyholders' surplus account. These figures are found on Page 1 of the Form 1120-L.

This is reflected in IAC § 100.2405(c)(1) which states that "taxable income properly reportable by the following taxpayers for federal income tax purposes shall mean":

> For life insurance companies taxable under Internal Revenue Code section 801, life insurance company taxable income, plus the amount of distribution from pre-1984 policyholder surplus accounts as calculated under Internal Revenue Code section 815a.

The above is also in the instructions to the Form IL-1120.

b) Tax Years Ending Before September 1, 1989

For years prior to September 1, 1989, Line 1 of the IL-1120 should be equal to the LICTI figure reported on Page 1 of the company's federal Form 1120-L. For Illinois purposes, this was determined by Public Act 76-261 which became effective August 1, 1969. It stated that taxable income properly reportable for federal income tax

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purposes shall mean "in the case of a life insurance company subject to the tax imposed by IRC § 802, Life Insurance Company Taxable Income."

During the period prior to September 1, 1989, the IRS made substantial changes in the method and forms used for computing LICTI. An understanding of this history is necessary. However, the federal changes do not result in procedural changes for the Illinois auditors. Illinois continued to utilize LICTI as computed federally, generally without re-computation. Following are highlights of the federal treatment in chronological order:

For tax years ended on or before December 31, 1983, the federal schedules used to calculate LICTI are Schedule C (Investment Income) and Schedule E (Operating Income). These schedules exclude the policyholder's share of total income in arriving at the company's share of total income, which is used in calculating LICTI. Since the Illinois addition modification for federally tax-exempt interest parallels the computation of LICTI, a detailed discussion of the federal computation is included below.

Taxable investment income (Schedule C) consists of the life insurance company's share of all items of investment yield (IRC § 804). Investment yield was defined as gross investment income less investment expenses and other deductions, such as tax-exempt interest and the dividends received deduction.

Gain from operations (Schedule E) consists of the life insurance company's share of items of investment yield and gross premiums and any net decrease in reserves per IRC § 809. The policyholder's share of investment yield items was specifically excluded from the gain from operations.

Utilizing these schedules, LICTI is computed for this period. It should be noted that the company's percentage would vary between Schedules C and E. Careful scrutiny of the federal Form 1120-L will give the auditor an understanding of the composition of the figures comprising LICTI. It is the lesser of the company's share of the income from investments (Schedule C), or the company's share of the income from the total operations (Schedule E), increased by one half of the difference of the gain from operations over the gain from investments (if any exists).

If taxable investment income exceeds gain from operations, taxable investment income is ignored and only the gain from operations is used in the computation of LICTI. (If Schedule C > Schedule E, use Schedule E only.) If taxable investment income is less than the gain from operations, LICTI will include the taxable investment income plus one half of the excess of the gain from operations over the

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investment income. (If Schedule C < Schedule E, use Schedule C plus ½ (Schedule E minus Schedule C.))

Example #1

Determine LICTI for Life Insurance Company B. Following is the company share information:

Investment income (Schedule C)	$10 million
Gain from operations (Schedule E)	$ 5 million

Calculation: (If Sch C > Sch E, use E).
$10 million > $5 million, use $5 million
Solution: LICTI = $5 million

Example #2

Determine LICTI for Life Insurance Company C. Following is the company share information:

Investment income (Schedule C)	$20 million
Gains from operations (Schedule E)	$30 million.

Calculation: (If Sch C < Sch E, use C plus ½ (Sch E – Sch C))
$20 million < $30 million, use $20 million + ½ ($30 million - $20 million)
= $20 million + ½ ($10 million)
= $20 million + $5 million
Solution: LICTI = $25 million

For tax years ending after December 31, 1983, the Deficit Reduction Act of 1984 substantially changed the method of computing LICTI federally. New IRC § 801 now imposed tax on life insurance companies. Illinois adjusted the IITA to refer to IRC § 801 instead of IRC § 802 with Public Act 85-293. Income for Illinois purposes still remained LICTI as computed federally.

In addition to adding IRC § 801, the Deficit Reduction Act established IRC § 815 to impose a special tax on distributions to shareholders from pre-1984 policyholders surplus accounts. These distributions were subject to tax federally as if they were a part of LICTI, but they were not specifically included in LICTI. Since Illinois did not have a specific provision to add the distributions to LICTI, the distributions could not be included in base income of the Illinois return until the necessary law change was passed on September 1, 1989.

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For tax years ended after December 31, 1987, another change occurred with the implementation of IRC §§ 846 and 847 dealing with the discounting of unpaid losses. This change created a situation where an Illinois auditor might have to do some adjustments to LICTI. When a federal consolidated return is filed claiming the IRC § 847 deduction for discounted unpaid losses, but not all the federal members are Illinois filers, some recalculation might be necessary for LICTI. See the discussion in the previous section for property and casualty companies at Casualty Companies (Fire, Marine, And Auto).. The IRC § 847 deduction for life insurance companies is found on the "Additional Deduction" line of Page 1 of federal Form 1120-L. The corresponding required estimated payment is found in the payment section on the line "Special Estimated Tax Payments."

B. MODIFICATIONS

Insurance companies are subject to the same IITA § 203(b) addition and subtraction modifications as any other corporation. For a general discussion of the various addition and subtraction modifications, refer to Chapters 24 and 25 of the Audit Manual.

There are, however, a few special rules associated with certain addition and subtraction modifications that are specific to insurance companies as follows.

1. Addition Modification For Federally Tax Exempt Interest

IITA § 203(b)(2)(A) requires an addition modification for an amount equal to all amounts paid or accrued to the taxpayer as interest during the taxable year to the extent excluded from gross income in the computation of taxable income.

a) Property and Casualty Companies

(1) For Tax Years Ending On Or After August 13, 1999 To Current

Public Act 91-541 (SB 1118) was signed on August 13, 1999. It amended IITA § 203(b)(2)(I) and related sections to provide that non-life insurance companies are not required to include in income any interest reported under IRC § 832(b)(5)(B) used to reduce the taxpayer's "loss incurred" deduction on their federal income tax return. Thus, for all tax periods ended on or after August 13, 1999, the addition modification for federally tax exempt interest will **still be 100%** of tax exempt interest. However, a **subtraction modification** will be allowed for the **15%** of tax-exempt interest that was utilized federally to reduce the deduction for losses incurred.

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The Department's policy for tax years ending on or after August 13, 1999 can be summarized as follows:

- For federally tax-exempt interest received or accrued on investments purchased prior to August 8, 1986, the proper addition modification will be 100% of the tax-exempt interest. IRC § 832(b)(5)(B)(i) does not require that the interest on these investments be included in the 15% adjustment to the deduction for losses incurred.

- For federally tax-exempt interest received or accrued on investments purchased on or after August 8, 1986, the proper addition modification will be 100% of the tax-exempt interest; however, a corresponding Illinois subtraction modification will be allowed. This Illinois subtraction is equal to the deductions disallowed under IRC § 832(b)(5(B)(i), which include, in part, 15% of federally tax-exempt interest that was added back federally for tax years ending on or after August 8, 1986.

(2) For Tax Years Ending Prior To August 13, 1999

For tax years ending prior to August 13, 1999, the Department took the position that 100% of the tax-exempt interest SHOULD still be added back to the Illinois return. However, during this period some non-life insurance companies argued that they should only be required to add back 85% of their federally tax-exempt interest as an addition modification for Illinois.

This issue started with tax years ending after December 31, 1986, due to the proration concepts added to the insurance provisions of the IRC by the Tax Reform Act of 1986. In the computation of ICTI, the IRS required that the deduction for “losses incurred” during the taxable year on insurance contracts be reduced by an amount equal to 15% of the federally tax-exempt interest received or accrued after August 7, 1986. (See IRC § 832(b)(5).) Schedule F of the federal 1120-PC computes this deduction. This in turn is deducted from gross income on Schedule A. In essence, this procedure increases ICTI by an amount equal to 15% of tax exempt interest received or accrued after August 7, 1986. Thus, the argument was made to add back only 85% of the tax-exempt interest to the Illinois return.

By examining the IITA § 203(b)(2)(A), and the intent of Congress in enacting the IRC § 832(b)(5)(B)(i) the argument for adding only 85% of tax-exempt interest was refuted.

The reasoning by the Department up until August 13, 1999 was as follows:

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The IITA § 203(b)(2)(A) provides for an addition modification to Illinois taxable income for federally tax-exempt interest excluded from gross income in computing taxable income. IRC § 103(a) initially excluded all of the tax-exempt interest from gross income. Thus, 100% should be added back. The fact that 15% of tax exempt interest was subsequently used to reduce the deduction for losses incurred in computing ICTI was considered immaterial for Illinois income tax purposes. When Congress enacted this procedure, the intent of this reduction in the "losses incurred" deduction was merely to deny the taxpayer a double deduction where deductible additions to reserves were funded with federally tax-exempt interest. The intent was NOT to include a portion of federally tax-exempt interest in ICTI. A final argument was made by comparing the disallowance of a deduction related to tax-exempt income to the similar disallowance in IRC §§ 171(a)(2), 265(a)(2), and 291(a)(3). IITA § 203(b)(2)(I) expressly allowed Illinois corporations to reverse these latter disallowances. However, a reversal of deductions disallowed under IRC § 832(b)(5)(B)(i) was NOT expressly allowed. Therefore, 100% of tax-exempt interest should be added back on the Illinois return.

The above policy was changed on February 23, 2000.

(3) February 23, 2000 Policy

The Department's prior policy was in effect until February 23, 2000. Due to the passing of Public Act 91-541 and the Circuit Court decisions in *Sentry Insurance v. Zehnder* and *St. Paul Fire and Marine Insurance Co. v. Zehnder*, the Department decided to change its policy.

(4) For Tax Years Ending Prior To August 13, 1999

The Department's current policy for the addition modification for municipal interest for property and casualty companies for tax years ending prior to August 13, 1999 follows:

- For federally tax-exempt interest received or accrued on investments purchased prior to August 8, 1986, the proper addition modification will be 100% of the tax-exempt interest. Internal Revenue Code (IRC) § 832(b)(5)(B)(i) does not require that the interest on these investments be included in the 15% adjustment to the deduction for losses incurred.

- For federally tax-exempt interest received or accrued on investments purchased on or after August 8, 1986, the proper addition modification will be 85% of the tax-exempt interest. The Circuit Court in the above-

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mentioned cases concluded that gross income of the non-life companies already included 15% of the federally tax-exempt interest income. IRC § 832(b)(5)(B)(i) required them to add back the 15% on Schedule F in the computation of their deduction for losses incurred.

b) Life Insurance Companies

The addition modification for federally tax-exempt interest under IITA § 203(b)(2)(A) was a source of much confusion over the years for life insurance companies. The main question was whether the company's share or the gross amount (company's and policyholders' shares) should be added back for Illinois purposes. For different periods of time, different audit procedures were in effect.

(1) Tax Years Ending On Or After December 31, 1994 to Current

Public Act 88-648 amended the IITA § 203(b)(3) special rule to state that, "For purposes of paragraph (2)(A), "gross income" in the case of a life insurance company, for tax years ending on and after December 31, 1994 and prior to December 31, 2011, shall mean the gross investment income for the taxable year." The term "gross investment income" includes the company's share and the policyholder's share of the income. Thus, for tax years ending on or after December 31, 1994, life insurance companies are required to add back both the company and policyholders' shares of tax-exempt interest as an addition modification on the Illinois return.

Public Act 97-0507 amended IITA § 203(b)(3) for purposes of defining "gross income" regarding the IITA § 203(b)(2)(A) addition modification. "Gross income" for tax years ending on or after December 31, 2011, means all amounts included in life insurance gross income under IRC § 803(a)(3).

The Annual Statement Schedule D is the main control document for the detail of the investment interest claimed on the federal Form 1120-L. Amounts claimed for tax-exempt interest on 1120-L Schedule F should be verified to the Annual Statement. The Illinois addition modification for this period is the total of both the company and policyholders' shares of tax-exempt interest.

(2) Tax Years Ending On Or Before December 31, 1994

For tax years ending prior to December 31, 1994, IITA § 203(b)(3) stated that, for purposes of the addition modification for federally-exempt interest, "gross income" in the case of a life insurance company shall mean the company's share of the gross investment income for the taxable year.

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Consequently, in the computation of Illinois base income, life insurance companies were required to add back ONLY the company's share of their federal tax-exempt interest prior to December 31, 1994. They were NOT required to add back the policyholder's share for this period, since the LICTI computation includes only the company share of tax-exempt interest. This is also supported by a 1996 Illinois administrative hearing decision.

The auditor should first verify the amount of tax-exempt interest claimed on the federal 1120-L to the Annual Statement Schedule D. This schedule is the main control document for the detail of the investments held by the insurance company.

Even though the company's share of federal tax-exempt interest is the only portion added back for the entire period through December 31, 1994, the federal schedules utilized in the computation were different prior to December 31, 1984. For years prior to December 31, 1984, a life insurance company's share of the addition modifications is calculated in a manner that exactly parallels the IRC formula used to compute a life insurance company's federal taxable income. If the life insurance company's gain from investments (Schedule C) is greater than the gain from operations (Schedule E), then the addition modification will be the company's share of tax-exempt interest in Schedule E. If the company's gain from investments (Schedule C) is less than the gain from operations (Schedule E), a different computation is made. The addition modification will be the Schedule C company share of tax-exempt interest increased by an amount equal to one half of the difference between the Schedule E company share of the modification and the Schedule C company share of the modification. The following examples show how the addition modification was computed prior to December 31, 1984.

<u>Example #3</u>

Part I: Determine LICTI for Life Insurance Company B. Following is the company share information:

Investment income (Schedule C)	$10 million
Gain from operations (Schedule E)	$ 5 million

Calculation: (If Sch C > Sch E, use E).
$10 million > $5 million, use $5 million
Solution: LICTI = $5 million

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Part II: Determine the addition modification for federally tax-exempt interest, using Part I and the following information:

Federally tax exempt interest in Schedule E investment yield	$2 million
Company's share of investment yield Schedule E	60%

Calculation: (If Sch C > Sch E in Part I, use Sch E's company share for Part II)
$10 million > $5 million for Part I
Use Sch E company share for Part II
(60% x $2 million)
Solution: Addition modification for Federally tax exempt interest = $1.2 million

<u>Example #4</u>

Part I: Determine LICTI for Life Insurance Company C. Following is the company share information:

Investment income (Schedule C)	$20 million
Gains from operations (Schedule E)	$30 million.

Calculation: (If Sch C < Sch E, use C plus ½ (Sch E – Sch C))
$20 million < $30 million, use $20 million + ½ ($30 million - $20 million)
= $20 million + ½ ($10 million)
= $20 million + $5 million
Solution: LICTI = $25 million

Part II: Determine the addition modification for Federally tax exempt interest, using Part I and the following information:

Federally tax exempt interest in Sch C investment yield	$2 million
Company Share Sch C investment yield	60%
Federally tax exempt interest in Sch E investment yield	$2 million
Company share Sch E investment yield	70%

Calculation: (Sch C < Sch E in Part I, so use Sch C's Co. share of modification + ½(Sch E's Co. share – Sch C's Co. share)
$20 million < $30 million in Part I
Use Sch C Co share + ½(Sch E's Co share – Sch C's Co Share)
= ($2 million x 60%) + ½(($2 million x 70%) – ($2 million x 60%))
= $1,200,000 + ½($1,400,000 - $1,200,000)
= $1,200,000 + ½($200,000)
= $1,200,000 + $100,000
Solution: Addition modification for federally tax exempt interest = $1,300,000

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With the Tax Reform Act of 1984 came significant changes to the schedules attached to the federal Form 1120-L. Consequently, auditors must utilize different federal tax schedules for different time periods as a part of verifying the addition modification for the company's share of federally tax-exempt interest. The method described above was no longer utilized on or after December 31, 1984. The calculation is much simpler. For years ended on or after December 31, 1984 but prior to December 31, 1992, the auditor can verify this modification by multiplying the tax-exempt interest amount on Schedule C of the federal 1120-L by the company's share percentage found on Schedule K, Part II. For tax years ending after December 31, 1992, there were additional substantial changes to the federal 1120-L Schedules. Thus, for tax years ending after December 31, 1992, the addition modification for tax-exempt interest can be verified by multiplying the tax-exempt interest shown on Schedule F of the federal 1120-L by the company's share percentage also found on Schedule F.

2. Addition Modification for Related Party Insurance Reimbursement Subtraction Modification

P.A. 97-0507, effective 8/23/11, created a new addition modification for insurance companies. The new provision is found under the subtraction modification IITA § 203(b)(2)(Y), shown below:

> (Y) For taxable years ending on or after December 31, 2011, in the case of a taxpayer who was required to add back any insurance premiums under Section 203(b)(2)(E-14), such taxpayer may elect to subtract that part of a reimbursement received from the insurance company equal to the amount of the expense or loss (including expenses incurred by the insurance company) that would have been taken into account as a deduction for federal income tax purposes if the expense or loss had been uninsured. If a taxpayer makes the election provided for by this subparagraph (Y), the insurer to which the premiums were paid must add back to income the amount subtracted by the taxpayer pursuant to this subparagraph (Y). This subparagraph (Y) is exempt from the provisions of Section 250; and [emphasis added]

If an insured affiliate takes the subtraction for reimbursed losses paid by the noncombination insurance company, then the insurance company must add back to its income what the insured affiliate subtracted. The insurance company reports this addition modification on the Schedule 80/20 (2015, Step 2, Line 12). Doing so follows the principle behind the 80/20 & noncombination modifications to nullify the tax effects of intercompany insurance contracts. Remember, this language does not create nexus for the insurance company. A foreign captive affiliate will only actually report this

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modification if it has nexus or is part of an Illinois UBG filing a combined return. The insured's eligibility for the IITA § 203(b)(2)(Y) reimbursement subtraction does not depend upon whether the insurance company has an Illinois filing requirement or actually adds back the reimbursement subtraction. However, when auditing an insurance company, the auditor should verify if any insured affiliate subtracted any insurance reimbursements under IITA § 203(b)(2)(Y) and if so, that the insurance company has added back the appropriate amounts.

Example 1: Captive Insurance Company CI, domiciled in Missouri, reimburses its noncombination Transportation Company T for losses to its trucking fleet from storm damage. T claims a $10 million dollar IITA § 203(b)(2)(Y) reimbursement subtraction. CI is an Illinois filer, but did not report a $10 million addition modification for the subtraction that T claimed. The auditor should make an audit adjustment so that CI reports the $10 million dollar addition modification required under IITA § 203(b)(2)(Y).

*Note: If CI did not have Illinois nexus, then it would not have to report the $10 million addition modification. T would still be eligible for the IITA § 203(b)(2)(Y) subtraction modification.

IITA § 203(b)(2)(Y) dealing with insurance reimbursement paid, is one of the two reversal noncombination insurance company modifications. The other is a subtraction modification under IITA § 203(b)(2)(V) for insurance premiums received. The purpose of the noncombination insurance company modifications is to eliminate the tax effects of transactions from insurance contracts between noncombination companies. See the 80-20 Example in "Subtraction Modification for Related Party Insurance Premiums" for an illustration of a captive insurance company reporting both of the noncombination reversal modifications on the Schedule 80/20.

3. Subtraction Modification For US Government And Certain Municipal Interest

Insurance companies are entitled to the same type of subtraction modifications as other corporations. For a complete discussion of these, see Audit Manual Chapter 25.

Non-life insurance companies take subtraction modifications like other corporations, so there are no special rules for their subtraction modifications. (See section below on dividends received through a mutual fund at Foreign Dividend Flow-Through From A Mutual Fund.) Life insurance companies, however, had controversy over the amount of US government and certain municipal interest that they are entitled to subtract on the Form IL-1120. IITA § 203(b)(2)(J) allows the subtraction modification, and Publication 101 and IAC § 100.2470 detail the qualifying items. The controversy was over whether

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the entire gross amount should be deducted, or just the company's share. The life insurance company subtraction modification for US Government and certain municipal interest will be handled in the following manner.

a) Tax Years Ending After December 31, 1983

The gross amount, both the policyholders' and company's shares of tax-exempt interest should be allowed as a subtraction modification. The Deficit Reduction Act of 1984 changed the definition of LICTI, including both the policyholders' and company's shares of US government interest in the computation. Be aware, however, that the US government interest subtraction modification requires the gross amount to be reduced by the bond premium amortization amount for years ended on or after January 1, 1992.

b) Tax Years Ending on or Before December 31, 1983

The subtraction modification should be limited to the company's share amount. Prior to 1983, the federal definition of LICTI excluded the policyholders' share of both investment income and gain from operations. Since IITA § 203(b)(2)(J) permits a subtraction modification for only those amounts included in the total of LICTI plus addition modifications, no subtraction can be allowed for the policyholders' share.

4. Foreign Dividend Flow-Through From A Mutual Fund

The issue is whether a dividend received by a taxpayer (i.e. Life Insurance Co.) from a mutual fund such as Acorn International that invests exclusively in foreign corporations can be claimed by the taxpayer as a subtraction modification for foreign dividends. Taxpayers have taken the position that it is an allowable subtraction modification because in the *Andras v. Department of Revenue* case a taxpayer that received a dividend from a mutual fund that invested U.S. Government securities was allowed a subtraction modification.

In *Andras* the Court allowed the subtraction modification to flow through to the taxpayer because there is a federal statute that provides that states cannot impose a direct or indirect tax on U.S. Government interest. If the taxpayers were not allowed a flow-through of the U.S. Government interest, it would amount to an indirect tax. The theory applied by the Court in this case would not apply to any other type of income.

A similar issue occurs with interest on obligations of state and local governments that are specifically exempted by the IITA. IAC § 100.2470(f) states that, "Income from these bonds is not exempt if the bonds are owned indirectly through owning shares in a mutual fund."

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Although, it is not stated in the regulations, the same would be true for foreign dividends. See Chief Counsel Advisory 200152046, 2001 WL 1660012 (Dividends from a mutual fund treated as a dividend from a U.S. corporation)

5. Subtraction Modification For An Attorney-In-Fact

Public Act 91-205 added a subtraction modification to IITA § 203(b)(2)(R) to allow an attorney-in-fact to claim an amount equal to the expenses disallowed on the reciprocal insurer's federal return when the reciprocal insurer made an IRC § 835 election. AMU IT 99-19 stated that this subtraction was effective for tax years ended on or after 7/20/99. However, after reviewing the legislative background, the General Counsel's office determined that the subtraction modification is effective retroactively. Public Act 94-789 retroactively reenacted the subtraction, which had sunset. This subtraction modification was exempted from IITA § 250 sunset.

a) Attorney-In-Fact/Reciprocal Insurer Relationship

To understand how this subtraction modification works, we must first have an understanding of the attorney-in-fact and its relationship with the reciprocal insurer or inter-insurer. A reciprocal or inter-insurer is a mutual organization composed of a group of persons, firms or corporations who agree to share each other's losses or risks. These parties are known as "subscribers." Each subscriber executes an identical agreement to empower an attorney-in-fact to represent them as a unit and manage their inter-insurance activities and policies. The attorney-in-fact is a separate company that operates on behalf of the policyholders, but it assumes no liability as an underwriter. Therefore, the attorney-in-fact is not considered an insurance company for Illinois or federal tax purposes. The reciprocal insurer pays the attorney-in-fact for its services, usually as a percentage of the premium income. This creates expenses that are recognized on the books of the reciprocal insurer, and income that is recognized on the books of the attorney-in-fact.

b) Federal Treatment

Under the IRC § 835, a reciprocal insurer is taxed as a mutual insurance company. The attorney-in-fact is not included on a consolidated return with the reciprocal insurer. However, there is a special provision in IRC § 835 which allows the reciprocal insurer to elect to effectively combine its tax liability with that of the attorney-in-fact. Once the election is made it is in effect for all succeeding years and cannot be revoked without federal consent.

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If the election is not made federally, the reciprocal insurer includes the full amount of expenses paid to the attorney-in-fact in the calculation of its federal taxable income. The attorney-in-fact reports the full amount of income from the reciprocal insurer on its federal return, and reduces that income by any business expenses to arrive at its federal taxable income.

If the election is made federally, there is no effect upon the calculation of the attorney-in-fact's federal taxable income. Income is still reduced by business expenses. Instead, the impact is seen on the reciprocal insurer's return. If the attorney-in-fact has federal taxable income, the reciprocal insurer does not expense the full amount of their payment to the attorney-in-fact. Instead, they are allowed to claim a smaller amount of expenses equal to the amount of actual business expenses the attorney-in-fact incurred for activity related to the insurer's business. In addition, the insurer also is allowed to claim a credit under IRC § 835(d) equal to the taxes paid by the attorney-in-fact on the income derived from the insurer. If the attorney-in-fact incurs a loss, the reciprocal insurer can deduct expenses equal to the amount of its payments to the attorney-in-fact.

c) Illinois Treatment

The subtraction modification allowed under IITA § 203(b)(2)(R) is only taken if the IRC § 835 election is made federally. For Illinois, the modification is taken on the attorney-in-fact's return rather than the reciprocal insurer's return. If the IRC § 835 election is made, a subtraction can be claimed by the attorney-in-fact in an amount equal to the expenses disallowed on the reciprocal insurer's federal return. The amount of disallowed expenses can be found on the reciprocal insurer's Schedule M-1 under "Expenses on books not on the return." The attorney-in-fact calculates their apportionment factor according to IITA § 304(a) rather than § 304(b). They cannot be included on the Illinois unitary return with the reciprocal insurers.

Example #5

Company A is a reciprocal insurer. Company B is the attorney-in-fact for Company A. Company A makes a IRC § 835 election.

A pays B $1,000,000 for services during the calendar year 1998. This $1,000,000 is B's only income. B incurs expenses of $400,000 in 1998, all of which are related to A's income. B pays $200,000 in federal taxes on the taxable income that results from this business activity.

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B's federal return:

Income	$1,000,000
Expenses	400,000
Taxable income	600,000
Federal Taxes	200,000

Because of the IRC § 835 election, A would claim as expenses on its federal return $400,000 of the $1,000,000 payment made to B. The other $600,000 would be disallowed and would be reported on A's M-1 Schedule. A would compute its taxable income and federal taxes and then claim an IRC § 835(d) credit based on B's taxes of $200,000.

Since the Illinois subtraction modification created by Public Act 91-205 is retroactive, it would be applicable to the in-statute 1998 tax year. Attorney-in-fact B would be entitled to the Public Act 91-205 subtraction modification rather than reciprocal insurer A. A's Illinois return will be unaffected. B would report federal taxable income of $600,000 on its Illinois return. Then, B would subtract the $600,000 of A's expenses that were disallowed on A's federal return because of the Section 835 election.

Example #6

Company C is a reciprocal insurer. Company D is the attorney-in-fact for Company C. Company C makes an IRC § 835 election.

C pays D $1,000,000 for services during calendar year 1998. This $1,000,000 is D's only income. D incurs expenses of $1,500,000 in 1998, all of which are related to C's income. D incurs a federal net operating loss from this business activity.

D's federal return:

Income	$1,000,000
Expenses	1,500,000
Taxable Loss	<500,000>

Under the Section 835 election, since D has a loss, C can only claim expenses on its federal return equal to the amount of its payments to D. So, C is limited to expenses of $1,000,000. Since D pays no federal taxes related to this income, C has no Section 835(d) credit and no disallowed expenses on Schedule M-1.

For Illinois, since the Public Act 91-205 modification is retroactive, it could be applicable to this year. However, since attorney-in-fact D incurred a federal net

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operating loss of $500,000, reciprocal insurer C would not have any disallowed expenses from the Section 835 election on C's federal return. The Illinois subtraction modification is only for the disallowed expenses. Thus, D cannot claim the Public Act 91-205 modification. D would report a loss of $500,000. C would report its federal taxable income.

6. Other Subtractions

For tax years ended on or after August 13, 1999, with the passing of Public Act 91-541 (SB 1118), non-life insurance companies are entitled to take an Illinois subtraction modification of 15% of federally-exempt interest that was used to reduce the federal deduction for losses incurred in computing ICTI. REF: IRC § 832(b)(5)(B)(i) and IITA § 203(b)(2)(I)(ii). This will be allowed under "other subtraction modifications." See discussion under modifications section at Addition Modification For Federally Tax Exempt Interest for a detailed explanation of how this subtraction originated. (IAC § 100.2455(f)).

Note: The subtraction modification is reported on 2015 Schedule M, Step 3, Line 15e as "Reduction in insurance company reserves (IRC § 835(b)(5)(B)(i))". It is called that because the 15% disallowance shows up as a reduction in the taxpayer's ending reserve.

In 2011, Public Act 97-0507 amended the interest subtraction for insurance companies to take into account the adjustments to reserves required when exempt interest is received, which applies to tax years ending on or after December 31, 2008. The additional language added to IITA § 203(b)(2)(I) allows the taxpayer to subtract:

> … the policyholders' share of tax-exempt interest of a life insurance company under Section 807(a)(2)(B) of the Internal Revenue Code (in the case of a life insurance company with gross income from a decrease in reserves for the tax year) or Section 807(b)(1)(B) of the Internal Revenue Code (in the case of a life insurance company allowed a deduction for an increase in reserves for the tax year)…

The Schedule M for years 2016 and after was updated and provides a specific line for this subtraction modification. The 2016 Schedule M allows it on line 15(e) "Change in insurance company reserves (IRC Section 807 or 832)". For years 2015 and before, the Schedule M does not provide a specific line for this subtraction modification related to IRC § 807. If the taxpayer received this type of exempt interest with reserve adjustments, the subtraction should be reported on the "Other eligible subtractions…" line on the Schedule M (Line 33, 2015 Schedule M).

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7. Subtraction Modification For Related Party Insurance Premiums

Because of the expansion of the Schedule 80/20 modifications to noncombination companies for taxable years ending on and after 12/31/08 and before 12/31/17, insurance companies are allowed a subtraction modification for insurance premiums received to the extent the affiliate reported them as an addition modification. For corporations, this subtraction modification is found under IITA § 203(b)(2)(V). Schedule 80/20 was amended starting in 2008 along with IAC § 100.2430 to reflect this subtraction modification. However, Public Act 100-22 eliminated the noncombination rule for taxable years ending on or after 12/31/17. This means the noncombination company insurance modifications only apply for taxable years ending on or after 12/31/08 and before 12/31/17. On or after TYE 12/31/17, insurance companies will join the same UBG with companies that apportion under different subsections of IITA § 304. The 2017 Schedule 80/20 reflects the removal of noncombination companies and insurance premiums modifications from the form. Fiscal year filers with years ending in 2017 must use the 2016 Schedule 80/20 for insurance company modifications.

Since the insurance company must qualify as a noncombination company, it would generally be a greater-than-50% owned captive unitary with the affiliated group (but for its different apportionment requirement). In other words, the insurance company meets all the unitary requirements to be included in the UBG, other than using an apportionment method different than the UBG.

IAC § 100.2430(b)(9) defines insurance premiums as the following:

> …the total amount paid or accrued during the taxable year, net of refunds or abatements, for coverage against any risk under a policy issued by an entity that is required to apportion its business income under the provisions of IITA Section 304(b) or that would be required to do so if it were subject to Illinois income taxation.

The following describes how the insurance premium modification works between the insured affiliate and the captive insurance company on a Schedule 80/20 for the applicable periods. If the Schedule 80/20 applies, then the insurance premium expenses paid to the captive insurance company are included on the affiliate's Schedule 80/20, Step 2, Line 9 starting in 2008 (lines may differ depending on the form year). This amount is reduced to the extent of any dividends received from the captive insurance company that flow through to Illinois base income. The net amount from Schedule 80/20 is carried to the UBG's Form IL-1120, Step 2 for addition modifications.

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> Note: Interest expenses or intangible expenses (such as royalties) paid to the captive insurance company would also be part of the addition modification.

If the captive insurance company files a Form IL-1120, then it will complete its own Schedule 80/20 and complete Step 1 and Lines 17 through 26 of Step 3, and carry the result to its Form IL-1120, Step 3 for subtraction modifications (lines may differ depending on the form year).

> Note: A captive insurance company that apportions its income under IITA § 304(b), including one located in a tax haven country like Bermuda, may be subject to Illinois income tax and have an Illinois insurance premium numerator under IAC § 100.3420(c) if it receives any kind of premiums based on risk in Illinois. There is a presumption of nexus if the taxpayer insures Illinois risk, but if rebutted by the taxpayer, then the auditor will have to develop a nexus position.

The premiums the captive subtracts cannot be included in its apportionment factor. This results from the principle that only receipts included in Illinois base income can be part of the apportionment factor. IAC § 100.3420(c)(1) provides the following:

> The apportionment factor shall take into account only those receipts that are included in either "gross premiums written" under section 832(b)(4)(A) of the Internal Revenue Code or "gross amount of premiums" under section 803(a)(1)(A) of the Internal Revenue Code. Only receipts that are included in federal taxable income of the taxpayer, and that are not subtracted in the computation of base income under a provision of Section 203 of the IITA, may be included in the apportionment factor. (See Continental Illinois National Bank and Trust Company of Chicago v. Lenckos, 102 Ill.2d 210 (1984).)

If a captive insurance only insured its unitary noncombination affiliates, it could potentially have to subtract all its premiums and have a zero-apportionment factor. For more information on the addition/subtraction modifications, see Audit Manual Chapters 24 & 25. For more information on apportionment, see section at APPORTIONMENT FORMULA in this Chapter and Chapter 27. For more information on captives, see section at Captive Insurance Companies in this Chapter.

If the UBG apportions its income under IITA § 304(a), then in order for Schedule 80/20 to apply, the captive insurance company must qualify as an insurance company under the provisions of the Internal Revenue Code (IRC) so that it is excluded from the UBG because it apportions its income under IITA § 304(b). If upon audit we determine that the captive insurance company does not meet the definition of an insurance company

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under the IRC so that the captive should apportion its income under IITA § 304(a), then we will include the captive insurance company in the UBG, making Schedule 80/20 inapplicable to those premiums.

If all of the members of the UBG including a captive insurance company are owned by a bank holding company under IITA § 1501(a)(8)(A), then all of the subsidiaries qualify for apportionment under IITA § 304(c), including the captive insurance company. Since the same apportionment method applies to all companies, the captive insurance company will be included in the unitary group and apportion its income under the rules in IAC §§ 100.3400 and 100.3405, making Schedule 80/20 inapplicable to those premiums.

See Audit Manual Chapters 24 and 25 for more information on the 80/20 modifications.

8. Example A: Captive Insurance Company, Noncombination Reversal Modifications

A unitary business group of transportation companies ("UBG") owns a captive insurance company ("Captive"). UBG apportions its business income under IITA § 304(d). Captive qualifies as an insurance company for federal, and therefore, Illinois purposes. Captive provides a variety of business lines of insurance for UBG and federally files a federal Form 1120-PC and is included in UBG's federal consolidated group.

For TYE 12/15, UBG paid insurance premiums of $25,000,000 to Captive for its annual insurance coverage. In 2015, UBG had damage to one of its truck and cargo, resulting in a $2,000,000 insurance claim that Captive reimbursed. That $2,000,000 otherwise would have been deductible on UBG's federal return as a loss under IRC § 165. Therefore, UBG correctly reported two modifications on its Illinois Schedule 80/20: a $25,000,000 insurance premiums addback (IITA § 203(b)(2)(E-12) and a $2,000,000 insurance reimbursement subtraction (IITA § 203(b)(2)(Y).

This entitles Captive to report the reversal modifications. Captive should report an addback modification required for UBG's $2,000,000 insurance reimbursement (IITA § 203(b)(2)(Y)). Captive should also report a subtraction modification for the $25,000,000 in insurance premiums it received that were added back by UBG (IITA § 203(b)(2)(V)). This set of modifications reported by UBG and Captive eliminates the tax effects of the related-party insurance contract between the two companies.

The following screenshots show what Captive would report on its 2015 Schedule 80/20, p. 1 and p. 3:

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Illinois Department of Revenue

2015 Schedule 80/20 Related-Party Expenses

Attach to your Form IL-1120, IL-1120-ST, IL-1065, or IL-1041. For tax years ending on or after December 31, 2015.

Year ending 12 (Month) 2015 (Year)

IL Attachment No. 14

Enter your name as shown on your Illinois tax return.: Captive

Enter your federal employer identification number (FEIN).: 22-2222222

Step 1: Identify your affiliated companies

		A	B	C	D - Totals
1	Enter the name of each affiliated company.	1 UBG			
2	Enter the FEIN for each affiliated company.	2 11-1111111	-	-	
2a	Check if this is a newly added affiliated company. See instructions.	☐	☐	☐	

Step 2: Figure your addition modifications

Note → All taxpayers may complete this section.

If you have more affiliated companies to report than space provided, complete and attach additional Schedules 80/20. Report the totals in column D of the last additional Schedule only.

		A	B	C	D - Totals
3a	Amount of interest paid to each affiliated company.	3a			
b	Interest exempt from the amount on Line 3a.	3b			
c	Subtract Line 3b from 3a.	3c			
4	Amount of dividends received from each affiliated company.	4			
5	Subtract Line 4 from Line 3c. If negative, enter "0" here and the result as a positive amount on Line 7.	5			5
6a	Intangible expenses paid to each affiliated company.	6a			
b	Intangible expenses amount on Line 6a exempt from addback.	6b			

Check the boxes on Line 6c to identify the reasons the amount on Line 6b is exempt from addback. You may check multiple boxes. See instructions.

		A	B	C	D - Totals
c	Foreign company or state	☐	☐	☐	
	No principal purpose	☐	☐	☐	
	Addback unreasonable	☐	☐	☐	
	Alternative apportionment	☐	☐	☐	
d	Subtract Line 6b from 6a.	6d			
7	Any excess of dividends received from each affiliated company on Line 4 over the interest expense addition on Line 3c.	7			
8	Subtract Line 7 from Line 6d. If negative, enter "0" here and enter the result as positive amount on Line 10.	8			8
9	Insurance premiums paid to each affiliated company.	9			
10	Any excess of dividends received from each affiliated company on Line 7 over the intangible expense addition on Line 6d.	10			
11	Subtract Line 10 from Line 9. If negative, enter "0."	11			11
12	**Insurance companies:** Insurance proceeds received from you that were claimed as a subtraction by any of your policy holders on Sch. 80/20, Line 18. See instr.	12 2,000,000.00			12 2,000,000.00
13	**Total addition modifications.** Add Lines 5, 8, 11 and 12. See instructions.	13 2,000,000.00			13 2,000,000.00

Schedule 80/20 (R-12/15) Page 1 of 3

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Illinois Department of Revenue
2015 Schedule 80/20

Captive — Enter your name as shown on your Illinois tax return.

2 2 - 2 2 2 2 2 2 2 — Enter your federal employer identification number (FEIN).

Read this information first - If you attach multiple copies of Schedule 80/20 to your return, complete this page once and attach it as the last page of Schedule 80/20. Failure to do so may result in a delay in the processing of your return.

Step 4: Figure your total subtraction modification

19	Enter the amount from Line 18.	19	0.00
20	Subtraction for losses insured by an affiliated insurance company. See instructions.	20	◇
21	Enter the name and FEIN of the affiliated insurance company from Line 20.	Name	
		FEIN	-

Note **If you are not an affiliated company,** skip Lines 22 through 31 and complete Line 32.

If you are an affiliated company, complete Lines 22 through 31 and Line 32.

22	Enter the name and FEIN of the U.S. company that paid you interest or intangible expenses.	Name	UBG
		FEIN	11 - 1111111
23	Enter the amount of interest received from the U.S. company.	23	◇
24	Enter the amount of interest paid to you from the U.S. company's Schedule 80/20, Line 5.	24	◇
25	Enter the lesser of Line 23 or Line 24.	25	
26	Enter the intangible income received from the U.S. company.	26	◇
27	Enter the amount of intangible expenses paid to you from the U.S. company's Schedule 80/20, Line 8.	27	◇
28	Enter the lesser of Line 26 or Line 27.	28	
29	Enter the amount of insurance premiums received from the U.S. company.	29	25,000,000.00 ◇
30	Enter the amount of insurance premiums paid to you from the U.S. company's Schedule 80/20, Line 11.	30	25,000,000.00 ◇
31	Enter the lesser of Line 29 or Line 30.	31	25,000,000.00

All taxpayers complete Line 32.

32	**Total subtraction modifications.** Add Lines 19, 20, 25, 28, and 31. Enter the amount here and see instructions.	32	25,000,000.00

Reset Print

This form is authorized as outlined by the Illinois Income Tax Act. Disclosure of this information is REQUIRED. Failure to provide information could result in a penalty.

Schedule 80/20 (R-12/15) Page 3 of 3

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C. NONBUSINESS INCOME ITEMS

Prior to 1995, the IL-1120 instructions, Part III- General Instructions, item 2A stated, "All income of an insurance company, including interest, dividends, rentals, and capital gains and losses, is business income under the IITA." The above statement has been deleted from the IL-1120 instructions since neither the IITA nor the IAC contains any language supporting this position. Insurance companies are subject to the same business and nonbusiness income rules as any other entity. REF: IAC § 100.3010.

See Audit Manual Chapter 26 for more information on nonbusiness income.

D. APPORTIONMENT FORMULA

All insurance companies are required to apportion their income under IITA § 304(b). IITA § 304(b)(1) states in part:

> ... [B]usiness income of an insurance company for a taxable year shall be apportioned to this State by multiplying such income by a fraction, the numerator of which is the direct premiums written for insurance upon property or risk in this State, and the denominator of which is the direct premiums written for insurance upon property or risk everywhere. For purposes of this subsection, the term "direct premiums written" means the total amount of direct premiums written, assessments and annuity considerations as reported for the taxable year on the annual statement filed by the company with the Illinois Director of Insurance in the form approved by the National Convention of Insurance Commissioners or such other form as may be prescribed in lieu thereof.

IAC § 100.3420(c) summarizes the items included in the factor:

- The apportionment factor can only include receipts that are included in either “gross premiums written” under IRC § 832(b)(4)(A) or “gross amounts of premiums” under IRC § 803(a)(1)(A) .

- Only those receipts (premiums) that are included in base income subject to apportionment are includible in the apportionment formula.

- Only direct premiums written for insurance, assessments against mutual policyholders and consideration for annuity contracts that include elements of insurance are included in the apportionment formula. Other receipts are excluded from the apportionment factor, even if included in net income.

The following receipts are not included in the premiums apportionment factor:

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- Interest, dividends, and other income from investments
- Gains and losses from adjustments to reserves
- Deposit-type funds
- Premiums on which state income taxes are prohibited by federal law

In cases where there is no Annual Statement or Schedule T, IAC § 100.3420(d) states:

> ...If an insurance company does not file an annual statement with the Director of Insurance or if any direct premiums written by an insurance company are not allocated to a specific state on its annual statement, that insurance company shall include in the numerator of its apportionment factor the direct premiums written for insurance on property or risk in this State, determined in accordance with the determination of gross taxable premium written under Section 409(1) of the Illinois Insurance Code [215 ILCS 5/409(1)]…

The above will apply to a captive insurance company since most of them do not file with the Director of Insurance. As long as the captive insures risk in Illinois and has nexus, it should have an Illinois premiums factor. Any insurance premiums received from an affiliate that are subtracted from base income under IAC § 100.2430(d)(5) are required to be excluded from the apportionment factor, also. For example, if a parent paid its captive insurance company $1,000,000 in insurance premiums that were subject to the IAC § 100.2430(c)(3) addition modification, the captive insurance would be allowed to subtract the $1,000,000 premiums from its base income. Since the $1,000,000 premiums were subtracted from base income, the captive insurance company would also have to exclude those premiums from its apportionment factor.

1. Property And Casualty Companies

The apportionment formula for a property and casualty insurance company will be Illinois direct premiums written divided by total direct premiums written. The information necessary to calculate the apportionment factor can be found on Schedule T -- Exhibit of Premiums Written of the Annual Statement filed with the Illinois Director of Insurance.

The amounts shown in Column 2 (Direct Premiums Written) are the only figures needed to calculate the apportionment formula. The total direct premiums everywhere are reported on Line 58 of Column 2. The Illinois direct premiums will be shown on Line 14 of Column 2. None of the items in Columns 3 through 8 should be included in the apportionment formula. The figures reported in Column 9 for Direct Premiums Written for Federal Purchasing Groups are included in the amounts reported in Column 2.

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Therefore, the auditor should only use the figures reported in Column 2 in calculating the apportionment factor.

The column and line references used above are for Schedule T in the 2008 Annual Statement for property and casualty companies. The format and line numbers for this schedule may be different in other years. As explained below, the format and line numbers on Schedule T in the Annual Statements for life insurance companies are different.

2. Life Insurance Companies

The apportionment formula for a life insurance company will be Illinois direct premiums written divided by total direct premiums written. The information necessary to calculate the apportionment factor can be found on Schedule T – Premiums and Annuity Considerations of the Annual Statement filed with the Illinois Director of Insurance.

The direct premiums written shown on Schedule T include life insurance premiums (Column 2), annuity considerations (Column 3), and accident and health insurance premiums (Column 4). The total direct premiums written for each of these items is reported on Line 59 (Columns 2 through 4). In addition, the direct premiums written should also include company contributions for employee benefits plans (Line 90- Columns 2 through 4), dividends applied to purchase paid-up additions (Line 91- Columns 2 through 4), dividends applied to shorten endowment or premium paying period (Line 92- Columns 2 through 4), premium or annuity considerations waived under disability or other contract provisions (Line 93- Columns 2 through 4), and aggregate other amounts not allocable by State (Line 94 Columns 2 through 4). In summary, the total direct premiums written should include all of the items included in the total direct business (Line 95 Columns 2 through 4).

There are two other items on the Schedule T which have caused some confusion in calculating the apportionment factor for insurance companies. These items are "reinsurance assumed" and "Deposit-Type Contracts" (see next section at Deposit-Type Funds). These two items are reported on the Schedule T for life insurance companies, but NOT for property and casualty companies. In calculating the total direct premiums everywhere for a regular insurance company, the auditor should NOT include any amounts reported for reinsurance assumed (Line 96). In addition, NO adjustment is required to the total direct premiums written (Line 95) for reinsurance ceded (Line 98). Reinsurance companies, defined by IITA § 304(b)(2), are handled differently than a regular insurance company. Refer to the section on reinsurance companies at Illinois Taxation of Reinsurance Companies.

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After calculating the amount of total direct premiums written, the amount of Illinois direct premiums written should be determined. The auditor needs to exercise care in calculating the Illinois portion because not all of the items included in the total premiums everywhere are broken down by state on Schedule T. The auditor should first pick up the Illinois premiums reported on Line 14 (Columns 2 through 4). This will account for all of the Illinois direct premiums written reported on the subtotal for direct premiums shown on Line 59 (Columns 2 through 4). The auditor will then have to request a state by state breakdown of the company contributions for employee benefit plans (reported on Line 90- Columns 2 through 4), dividends applied to purchase paid-up additions (reported on Line 91- Columns 2 through 4), dividends applied to shorten endowment or premium paying period (reported on Line 92- Columns 2 through 4), premium or annuity considerations waived under disability or other contract provisions (reported on Line 93- Columns 2 through 4), and aggregate other amounts not allocable by state (reported on Line 94 Columns 2 through 4).

In almost all instances, the taxpayer should be able to provide a state-by-state breakdown of the above items. In the rare event that the taxpayer is unable to provide a state-by-state breakdown of any of the above items, the item for which the taxpayer cannot provide a state-by-state breakdown should be excluded from the apportionment factor. There are no throwback provisions in the IITA for the insurance apportionment factor.

The column and line references used in this section are for Schedule T in the 2008 Annual Statement for life insurance companies. The format and line numbers for this schedule may be different in other years.

3. Deposit-Type Funds

The National Association of Insurance Commissioners (NAIC) explains deposit-type funds in their Statement of Statutory Accounting Principles No.50, Classification and Definitions of Insurance Contracts in Force:

> Deposit-type contracts do not incorporate insurance risk. Contracts issued by insurers that do not incorporate risk from the death or disability of policyholders (mortality or morbidity risk) are more comparable to financial or investment instruments issued by other financial institutions than to insurance contracts.

It then goes on to say:

> [D]eposit-type contracts shall include all contracts without any life or disability contingencies, including, but not limited to, certain types of the following policy categories:

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- Supplemental contracts
- Lottery payouts
- Structured settlements
- Guaranteed interest contracts
- Income settlement options
- Dividend and coupon accumulations
- Annuities certain
- Premium and other deposit funds

The most common example of items included in this column is amounts received by an insurance company to purchase a deferred annuity.

For 1990 and subsequent years, deposit-type funds can be found of Schedule T, Column 6 and Line 1(a) of the summary of operations. In 1990, the format of Schedule T was changed to add Column 6 that was originally described as "annuity and other fund deposits" and was subsequently described as "deposit-type funds". By 2008, deposit-type funds were reported under “Deposit-Type Contracts” in Column 7 of the Schedule T for life insurance companies.

a) History of Reporting Deposit-Type Funds

Historically the Department’s view was that deposit-type funds should be excluded from the factor. However, in an Administrative Hearing decision on ABC Co., IT# 04-1 (the cleansed name) dated December 5, 2003, the ALJ ruled that deposit-type funds should be included in the numerator and denominator of the taxpayer’s apportionment formula.

After that hearing the Department issued IAC § 100.3420 that addressed deposit-type funds and other issues. It is the Department position that deposit-type funds should not be included in the apportionment factor. It states in IAC § 100.3420(c)(3):

> (3) Examples of receipts that are excluded from the apportionment factor include:
>
> > (C) Deposit-type funds. This is due to the fact that deposit-type funds involve no insurance risk and are therefore reported separately from premiums, assessments and annuity consideration on the annual report.

The regulation applies retroactively to all years that are within statute.

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b) The Department's Policy

The Department's policy is as follows on DTF (Deposit-Type Funds).

- All DTF will be excluded from the numerator and denominator of the insurance factor for all years.

- If the auditor included DTF in an unagreed audit that is before the Informal Conference Board (ICB), the auditor should contact the ICB conferee concerning that issue. If there are other unagreed issues before ICB, they will have to be resolved by ICB prior to issuing the Action Decision.

- In cases where the auditor included DTF in the insurance factor and the taxpayer signed the IL-870 with payment, the auditor will need to revise the IL-870 and create the claim for refund, if excluding the DTF creates a refund. The incorrect IL-870 will be marked SUPERSEDED.

- If the auditor included the DTF in the insurance factor, and the taxpayer signed the IL-870 creating an overpayment, the IL-870 must be revised and the auditor will have to issue an EDA-122 if the change creates a liability. The taxpayer will have the right to go to ICB. However, if the statute of limitations will expire prior to the expiration of the 60-day period for seeking ICB Review and the taxpayer will not extend the statute of limitations, then the taxpayer cannot go to ICB. In this situation, an EDA-122 should not be issued. The auditor will need to issue a new EDA-143 Audit Results with the new figures.

  Note: If there is less than six months remaining on the statute, you should discuss the proper procedure with your supervisor since the audit must still be submitted to Audit Review with at least four months remaining on the statute.

- If the auditor included DTF in the insurance factor and the case has been submitted to Technical Review, and GenTax shows that the audit has not been processed, the auditor will need to email Tad Tucker to have the case returned for revision. If there is a statute problem and an IL-872 waiver cannot be obtained, it will be up to Technical Review to have either a Reviewer or someone from Discovery reverse the DTF factor.

- If DTF were included in the factor and the audit has been processed, the auditor should contact the taxpayer and advise them to file claims for

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credit, if excluding the DTF from the factor will create a refund. If the audit resulted in a refund and excluding DTF will reduce the refund, then the auditor should submit an SC-137 Request For Audit and attempt to reaudit those periods and recover the refund under the erroneous refund provisions. If the normal statute period has expired, the Department has 2 years from the date of the erroneous refund to issue a Notice of Deficiency under IITA § 905(g) and IAC § 100.9320(g). The auditor should request a new track number.

Note: An IL-872 cannot be used to extend the two-year erroneous refund statute in IITA § 905(g). If there is a short-period remaining on this statute, the auditor will have to submit an SC-137 Referral for Audit and recommend that Office Programs or Discovery do a quick reaudit.

Example #7

An insurance company timely files its 2005 and 2006 Forms IL-1120 by the extended due date and excludes DTF from its insurance premiums factor. On December 15, 2007, the taxpayer files a Form IL-1120-X for 2005 to include DTF in the factor and receives a refund of $10,000. The taxpayer files no amended return for 2006. The auditor will exclude the DTF from the insurance factor for 2005 and recover the refund. If the IL-1120-X has not been processed, the auditor will issue an EDA-125 Notice of Proposed Claim Denial.

Example #8

The taxpayer excluded DTF for 2003 and 2004, but the auditor included the DTF. The taxpayer agreed to the changes and received a refund for both years. There are now amended returns for 2003 and 2004 that increase~~s~~ federal taxable income. The normal statute on 2003 is expired, but the erroneous refund provisions are within statute. The auditor should reverse the audit adjustment for both years and attempt to recover the refund.

Example #9

The taxpayer included the DTF for 2003 and 2004 and the auditor made no audit adjustment to the DTF. The audit was processed. Now there is an RAR for both years that increases federal taxable income. The normal statute on 2003 is expired. Excluding DTF from the factor creates a liability. The auditor cannot exclude the DTF from the insurance factor for 2003 because that statute is expired. Where the statute is expired, we can only assess the tax due on the RAR using the existing

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factor in GenTax. However, if excluding DTF for 2003 decreases the RAR tax due, we can change the factor to reduce the amount of tax due from the RAR. In either case the factor can be changed for 2004 if it is within statute.

Example #10

The taxpayer included DTF for 2003 and 2004 and the auditor made no audit adjustment to the DTF. The audit was processed. Now there is an RAR for both years that decreases federal taxable income. As a result of the RAR, the taxpayer has filed Forms IL-1120-X for 2003 requesting a refund of $10,000 and $15,000 for 2004. The statutes for both 2003 and 2004 have expired. The auditor can exclude the DTF from the numerator and denominator and reduce the refunds in each year to zero (since no notice will be issued, there is no statute – see *Lewis v. Reynolds*). The claims can only be reduced to zero – no deficiency can be proposed.

4. Schedule T Examples

The primary source document for insurance company apportionment information is the taxpayer's Schedule T from their Annual Statement. Schedule S (Life) or Schedule F (nonlife) can be used if reinsurance premium information is needed. Other schedules, like Schedule P, may also show reinsurance information. The following two screenshots show the 2018 version of the Schedule T. Example 1 shows the 2018 Schedule T for property and casualty companies. Example 2 shows the 2018 Schedule T for a life insurance company. Some comments are shown below each example noting the critical lines for apportionment purposes.

*Note: The information highlighted was not done by Technical Support to emphasize anything. That simply was highlighted by the NAIC in the draft PDFs available online. Remember, the Schedule T line names and numbers in these examples may differ, depending on the tax year.

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Example A: 2018 Schedule T, Property and Casualty

SCHEDULE T – EXHIBIT OF PREMIUMS WRITTEN
Allocated By States And Territories

States, Etc.	1 Active Status (a)	Gross Premiums, Including Policy and Membership Fees Less Return Premiums and Premiums on Policies Not Taken: 2 Direct Premiums Written	3 Direct Premiums Earned	4 Dividends Paid or Credited to Policyholders on Direct Business	5 Direct Losses Paid (Deducting Salvage)	6 Direct Losses Incurred	7 Direct Losses Unpaid	8 Finance and Service Charges Not Included in Premiums	9 Direct Premium Written for Federal Purchasing Groups (Included in Col. 2)
1. Alabama AL									
2. Alaska AK									
3. Arizona AZ									
4. Arkansas AR									
5. California CA									
6. Colorado CO									
7. Connecticut CT									
8. Delaware DE									
9. Dist. Columbia DC									
10. Florida FL									
11. Georgia GA									
12. Hawaii HI									
13. Idaho ID									
14. Illinois IL									
15. Indiana IN									
16. Iowa IA									
17. Kansas KS									
18. Kentucky KY									
19. Louisiana LA									
20. Maine ME									
21. Maryland MD									
22. Massachusetts MA									
23. Michigan MI									
24. Minnesota MN									
25. Mississippi MS									
26. Missouri MO									
27. Montana MT									
28. Nebraska NE									
29. Nevada NV									
30. New Hampshire NH									
31. New Jersey NJ									
32. New Mexico NM									
33. New York NY									
34. No. Carolina NC									
35. No. Dakota ND									
36. Ohio OH									
37. Oklahoma OK									
38. Oregon OR									
39. Pennsylvania PA									
40. Rhode Island RI									
41. So. Carolina SC									
42. So. Dakota SD									
43. Tennessee TN									
44. Texas TX									
45. Utah UT									
46. Vermont VT									
47. Virginia VA									
48. Washington WA									
49. West Virginia WV									
50. Wisconsin WI									
51. Wyoming WY									
52. American Samoa AS									
53. Guam GU									
54. Puerto Rico PR									
55. U.S. Virgin Islands VI									
56. Northern Mariana Islands MP									
57. Canada CAN									
58. Aggregate other alien OT	XXX								
59. Totals	XXX								
DETAILS OF WRITE-INS									
58001.	XXX								
58002.	XXX								
58003.	XXX								
58998. Sum. of remaining write-ins for Line 58 from overflow page	XXX								
58999. Totals (Lines 58001 through 58003+58998) (Line 58 above)	XXX								

(a) Active Status Counts:

L – Licensed or Chartered - Licensed insurance carrier or domiciled RRG
E – Eligible - Reporting entities eligible or approved to write surplus lines in the state (other than their state of domicile – See DSLI) _____
D – Domestic Surplus Lines Insurer (DSLI) – Reporting entities authorized to write surplus lines in the state of domicile _____
R – Registered - Non-domiciled RRGs
Q – Qualified - Qualified or accredited reinsurer _____
N – None of the above – Not allowed to write business in the state _____

(b) Explanation of basis of allocation of premiums by states, etc.

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Determining the apportionment factor for a property and casualty insurance company under IITA § 304(b)(1) should usually be straightforward. Generally, this will only require pulling two lines off the Schedule T, Column 2 "Direct Premiums Written". On the form above, the Illinois direct premiums written are in Column 2, Row 14 ("Illinois"). That would be the Illinois numerator. The direct premiums written everywhere are found under Column 2, Row 59 ("Totals"). That would be the Illinois denominator.

Determining the taxpayer's apportionment factor requires the auditor to obtain the Annual Statement for each insurance company under audit. If the property and casualty insurance company qualifies as a reinsurance company and apportions under IITA § 304(b)(2), the auditor will need to obtain the Schedule F and related schedules for reinsurance premiums. See section "G. ILLINOIS TAXATION OF REINSURANCE COMPANY" for more information on reinsurance companies.

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Example 2: 2018 Schedule T, Health

SCHEDULE T – PREMIUMS AND OTHER CONSIDERATIONS
Allocated by States and Territories

		Direct Business Only							
	1	2	3	4	5	6	7	8	9
State, Etc.	Active Status (a)	Accident & Health Premiums	Medicare Title XVIII	Medicaid Title XIX	Federal Employees Health Benefits Plan Premiums	Life & Annuity Premiums & Other Considerations	Property/Casualty Premiums	Total Columns 2 Through 7	Deposit–Type Contracts
1. Alabama AL									
2. Alaska AK									
3. Arizona AZ									
4. Arkansas AR									
5. California CA									
6. Colorado CO									
7. Connecticut CT									
8. Delaware DE									
9. Dist. Columbia DC									
10. Florida FL									
11. Georgia GA									
12. Hawaii HI									
13. Idaho ID									
14. Illinois IL									
15. Indiana IN									
16. Iowa IA									
17. Kansas KS									
18. Kentucky KY									
19. Louisiana LA									
20. Maine ME									
21. Maryland MD									
22. Massachusetts MA									
23. Michigan MI									
24. Minnesota MN									
25. Mississippi MS									
26. Missouri MO									
27. Montana MT									
28. Nebraska NE									
29. Nevada NV									
30. New Hampshire NH									
31. New Jersey NJ									
32. New Mexico NM									
33. New York NY									
34. North Carolina NC									
35. North Dakota ND									
36. Ohio OH									
37. Oklahoma OK									
38. Oregon OR									
39. Pennsylvania PA									
40. Rhode Island RI									
41. South Carolina SC									
42. South Dakota SD									
43. Tennessee TN									
44. Texas TX									
45. Utah UT									
46. Vermont VT									
47. Virginia VA									
48. Washington WA									
49. West Virginia WV									
50. Wisconsin WI									
51. Wyoming WY									
52. American Samoa AS									
53. Guam GU									
54. Puerto Rico PR									
55. U.S. Virgin Islands VI									
56. Northern Mariana Islands MP									
57. Canada CAN									
58. Aggregate other alien OT	XXX								
59. Subtotal	XXX								
60. Reporting entity contributions for Employee Benefit Plans	XXX								
61. Total (Direct Business)	XXX								
DETAILS OF WRITE-INS									
58001.	XXX								
58002.	XXX								
58003.	XXX								
58998. Summary of remaining write-ins for Line 58 from overflow page	XXX								
58999. Totals (Lines 58001 through 58003 plus 58998) (Line 58 above)	XXX								

(a) Active Status Counts:
L – Licensed or Chartered - Licensed insurance carrier or domiciled RRG
R – Registered - Non-domiciled RRGs
E – Eligible - Reporting entities eligible or approved to write surplus lines in the state
Q – Qualified - Qualified or accredited reinsurer
N – None of the above - Not allowed to write business in the state

(b) Explanation of basis of allocation by states, premiums by state, etc.

Determining the apportionment factor for a health insurance company under IITA § 304(b)(1) is similar to a property and casualty insurance company. The principal

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difference is that the health insurance has a few additional columns for lines of insurance to consider. This Schedule T is showing six different columns where the insurer can allocate premiums:

- 2. Accident & Health Premiums
- 3. Medicare Title XVIII
- 4. Medicaid Title XIX
- 5. Federal Employees Health Benefits Plan Premiums
- 6. Life & Annuity Premiums & Other Considerations
- 7. Property/Casualty Premiums

Any amounts in these columns allocated to Illinois (row #14) are included in the Illinois numerator. The totals of the columns 2-7 are in column 8. Essentially, the amount reported to Illinois in Column 8 should be the Illinois numerator, unless the company has not included any factor premiums in the Schedule T. Remember, Column 9 Deposit-Type Contracts, should not be included in the apportionment factor (IAC § 100.3420(c)(3)(C)).

In the past, premiums under *3. Medicare Title XVIII* have caused confusion about being included in the factor. Because of the language in IAC § 100.3420(d), certain insurance receipts normally excluded from taxation by the Illinois Insurance Code are included in our apportionment factor. This is the basis to include receipts from *Medicare Title XVIII, Medicaid Title XIX,* and *Federal Employees Health Benefits Plan Premiums* in the apportionment factor.

The other difference from the property & casualty is Row 60 *Reporting entity contributions for Employee Benefit Plans*. If there is an amount on this line, the auditor will need to request a state-by-state breakdown schedule of this line, in order to verify amounts allocable to Illinois. If the taxpayer does not provide that support, this line should be excluded from the factor.

The denominator will be Column 8, Line 61 *Total (Direct Business)* if there is an included amount on Line 60. If there is no amount on Line 60 or it is excluded, then Column 8 Line 59 *Subtotal* would be the denominator.

Determining the taxpayer's apportionment factor requires the auditor to obtain the Annual Statement for each insurance company under audit. If the health insurance company qualifies as a reinsurance company and apportions under IITA § 304(b)(2), the auditor will need to obtain the Schedule F and other related schedules for reinsurance premiums. See section "G. ILLINOIS TAXATION OF REINSURANCE COMPANY" for more information on reinsurance companies.

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Example 3: 2018 Schedule T, Life

ANNUAL STATEMENT FOR THE YEAR 2018 OF THE

SCHEDULE T – PREMIUMS AND ANNUITY CONSIDERATIONS
Allocated by States and Territories

	1	Direct Business Only					
		Life Contracts		4	5	6	7
States, Etc.	Active Status (a)	2 Life Insurance Premiums	3 Annuity Considerations	Accident and Health Insurance Premiums, Including Policy, Membership and Other Fees	Other Considerations	Total Columns 2 through 5	Deposit -Type Contracts
1. Alabama AL							
2. Alaska AK							
3. Arizona AZ							
4. Arkansas AR							
5. California CA							
6. Colorado CO							
7. Connecticut CT							
8. Delaware DE							
9. District of Columbia DC							
10. Florida FL							
11. Georgia GA							
12. Hawaii HI							
13. Idaho ID							
14. Illinois IL							
15. Indiana IN							
16. Iowa IA							
17. Kansas KS							
18. Kentucky KY							
19. Louisiana LA							
20. Maine ME							
21. Maryland MD							
22. Massachusetts MA							
23. Michigan MI							
24. Minnesota MN							
25. Mississippi MS							
26. Missouri MO							
27. Montana MT							
28. Nebraska NE							
29. Nevada NV							
30. New Hampshire NH							
31. New Jersey NJ							
32. New Mexico NM							
33. New York NY							
34. North Carolina NC							
35. North Dakota ND							
36. Ohio OH							
37. Oklahoma OK							
38. Oregon OR							
39. Pennsylvania PA							
40. Rhode Island RI							
41. South Carolina SC							
42. South Dakota SD							
43. Tennessee TN							
44. Texas TX							
45. Utah UT							
46. Vermont VT							
47. Virginia VA							
48. Washington WA							
49. West Virginia WV							
50. Wisconsin WI							
51. Wyoming WY							
52. American Samoa AS							
53. Guam GU							
54. Puerto Rico PR							
55. US Virgin Islands VI							
56. Northern Mariana Islands MP							
57. Canada CAN							
58. Aggregate Other Alien OT	XXX						
59. Subtotal	XXX						
90. Reporting entity contributions for employee benefits plans	XXX						
91. Dividends or refunds applied to purchase paid-up additions and annuities	XXX						
92. Dividends or refunds applied to shorten endowment or premium paying period	XXX						
93. Premium or annuity considerations waived under disability or other contract provisions	XXX						
94. Aggregate other amounts not allocable by State	XXX						
95. Totals (Direct Business)	XXX						
96. Plus reinsurance assumed	XXX						
97. Totals (All Business)	XXX						
98. Less reinsurance ceded	XXX						
99. Totals (All Business) less Reinsurance Ceded	XXX			(b)			
DETAILS OF WRITE-INS							
58001.	XXX						
58002.	XXX						
58003.	XXX						
58998. Summary of remaining write-ins for Line 58 from overflow page	XXX						
58999. Total (Lines 58001 through 58003 + 58998) (Line 58 above)	XXX						
9401.	XXX						
9402.	XXX						
9403.	XXX						
9498. Summary of remaining write-ins for Line 94 from overflow page	XXX						
9499. Total (Lines 9401 through 9403 + 9498) (Line 94 above)	XXX						

(a) Active Status Counts:
L – Licensed or Chartered - Licensed insurance carrier or domiciled RRG _____ R – Registered - Non-domiciled RRGs _____
E – Eligible - Reporting entities eligible or approved to write surplus lines in the state _____ Q – Qualified - Qualified or accredited reinsurer _____
N – None of the above - Not allowed to write business in the state _____

(b) Explanation of basis of allocation by states, etc., of premiums and annuity considerations:

(d) Column 4 should balance with Exhibit 1, Lines 6.4, 10.4 and 16.4, Cols. 8, 9 and 10, or with Schedule H, Part 1, Column 1, Line 1 indicate which: _____

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Determining the apportionment factor for a life insurance company under IITA § 304(b)(1) is similar to a health insurance company. The principal difference is that the life insurance has fewer columns of insurance lines. It does not have columns for

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Medicare, Medicaid, Federal Employees, and Property/Casualty. The following columns are where the auditor would pick up the Illinois premiums and everywhere:

- 2. Life Insurance Premiums
- 3. Annuity Considerations
- 4. Accident and Health Insurance Premiums, Including Policy, Membership, and Other Fees

Any amounts in these columns allocated to Illinois (row #14) are included in the Illinois numerator. Remember, Column 7 *Deposit-Type Contracts*, should not be included in the apportionment factor (IAC § 100.3420(c)(3)(C)).

The life insurance Schedule T has Row 90 *Reporting entity contributions for Employee Benefit Plans*, similar to health insurance companies. However, a life insurance Schedule T has four other aggregate lines the auditor has to consider. These five lines are as follows:

- 90. Reporting entity contributions for employee benefits plans
- 91. Dividends or refunds applied to purchase paid-up additions and annuities
- 92. Dividends or refunds applied to shorten endowment or premium paying period
- 93. Premium or annuity considerations waived under disability or other contract provisions
- 94. Aggregate other amounts not allocable by State

If there is an amount on these lines, the auditor will need to request a state-by-state breakdown schedule for the lines, in order to verify amounts allocable to Illinois. If the taxpayer does not provide that support, amounts on these lines should be excluded from the factor.

The denominator will be the total of Columns 2, 3, 4 on Line 95 *Totals (Direct Business)*. Remember to back out any amounts on Lines 90-94 if not supported by a state allocation schedule.

Determining the taxpayer's apportionment factor requires obtaining the Annual Statement for each insurance company under audit from the taxpayer. If the life insurance company qualifies as a reinsurance company and apportions under IITA § 304(b)(2), the auditor will need to review the Schedule S for reinsurance premiums. Line 96 *Plus reinsurance assumed* indicates the amount of premiums received from reinsurance and can be used in the Reinsurance test. See section "G. ILLINOIS TAXATION OF REINSURANCE COMPANY" for more information on reinsurance companies.

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E. IITA § 201(D-1) RATE REDUCTION FOR FOREIGN INSURERS

PA 91-643 (1999) added IITA § 201(d-1) to reduce taxes on insurance companies domiciled in states that do not impose income tax on insurance companies or tax them at a lower rate than does Illinois. This section reduces the regular and replacement tax rates to the point where the total net tax (net of all credits) owed by a foreign insurer is equal to the income tax it would pay to its home state on the amount of business conducted in Illinois. In 1999 the Department developed Schedule INS and UB/INS for taxpayers to use in computing this reduction.

Every state in the union has a retaliatory tax on insurance companies. Under a retaliatory tax, a foreign* insurance company adds up all the taxes it owes to the state for the year, and then computes all the taxes it would owe to its state of domicile if it were domiciled in the taxing state and was conducting the same amount of business in its home state that it is conducting in the taxing state. If the sum of these pro forma taxes is higher than the sum of the actual taxes, the excess is the amount of retaliatory tax owed.

> *Note: A foreign insurer is one formed under any law other than Illinois law. Because most (if not all) states require an insurance company formed under their law to be domiciled within the state as well, most commonly it refers to a foreign insurer domiciled in another state.

Because Illinois is one of the few states that impose its income tax on insurance companies, Illinois-domiciled companies are almost automatically subject to retaliatory tax equal to their pro forma Illinois income tax on their business done in every state outside Illinois. IITA § 201(d-1) minimizes those retaliatory taxes by reducing foreign companies' income tax to the amount they would pay to their home state on the same income. If a state imposes no income tax, the Illinois income tax on insurance companies domiciled in that state is reduced to zero.

This reduction is limited so that it never reduces a company's total Illinois taxes to an amount less than 1.75% of its taxable Illinois premiums. This amount is slightly below the most common insurance company privilege tax imposed by states, which is 2% of premiums. Reducing a company's total Illinois taxes below the 2% amount will not cause any further reduction in retaliatory tax owed by an Illinois company in one of those states; all it does is reduce Illinois revenues. So setting a 1.75% floor gives Illinois companies a little leeway in states with lower privilege taxes, while still limiting our revenue losses.

> Note: Originally the floor was 1.25%, but this was increased to 1.75% by PA 93-029 effective for tax years ending on or after December 31, 2003.

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For TYE 12/31/17 and after, insurance companies will be able to be combined with other companies that apportion under different subsections of IITA § 304. This is the elimination of the "noncombination rule" (see F. NONCOMBINATION RULE UPDATE section). However, foreign insurers will still be able to use the Sch. UB/INS as before to determine if any rate reduction applies to the foreign insurers that are members of a unitary business group (UBG) that would lower the UBG's Illinois tax liability.

Example #11:

If an Indiana insurance company incurs a total liability for all kinds of Illinois taxes (other than the retaliatory tax) equal to $1,000, and an Illinois company doing the exact same business in Indiana would incur a liability of $1,200, the Illinois retaliatory tax statute imposes a $200 liability on the Indiana company payable on IL446-0126-P Privilege and Retaliatory Tax Return for Property and Casualty Insurers filed with the Illinois Department of Insurance. See regulation Title 50, Part 2515. The Schedule INS does not allow the Indiana company to reduce its Illinois income tax and replacement tax.

1. Legislative History and Foreign State's Treatment of Illinois Insurers

Section 201(d-1) was added to the IITA by PA 91-643 (SB 338). The legislative history indicates that the purpose of IITA § 201(d-1) was to prevent Illinois from imposing a higher income tax on a foreign insurance company than the foreign insurance company's state imposes on Illinois insurance companies. This is to prevent application of the foreign state's retaliatory tax against Illinois companies. During floor debate regarding SB 338, Senator Peterson described the purpose of the bill as follows:

> [The bill] provides that if a foreign insurer's based in the State that imposes an income tax on Illinois insurers doing business in the State, then the Illinois income tax and personal property replacement tax income tax rates shall be reduced to the dollar amount of these Illinois taxes equal that tax in the foreign insurer's state on the same income. (State of Illinois, 91st G.A., Senate Transcript p. 129, 54th Legislative Day, May 27, 1999)

In the House, Representative Moore described the purpose of SB 338:

> As you know, Illinois insurance companies currently pay taxes to states all across the nation in the form of retaliatory taxes. And these taxes are imposed to retaliate for any amount that the Illinois charges to insurance companies domiciled outside of Illinois. The reason for the change is that the home states of the foreign-based insurance companies are now charging Illinois companies retaliatory taxes. (State of Illinois, 91st G.A., House Transcript p. 71, 58th Legislative Day, May 25, 1999)

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IITA § 201(d-1) was later amended by PA 91-0860 (SB 1326). Among other changes, SB 1326 exempted IITA Sec. 201(d-1) from sunset. During floor debate, Representative Moore again described the purpose of IITA § 201(d-1):

> Senate Bill 1326 amends the Income Tax Act concerning the rate reduction allowed for foreign insurers. Insurers, foreign and domestic, pay both a premium tax and a corporate tax – income tax in Illinois. The majority of states only impose a premium tax. Thus, Illinois insurers are subject to retaliation based on the Illinois income tax in those states. Paying these higher taxes means Illinois insurers are at a competitive disadvantage in other states. As a solution, you may remember that we passed Senate Bill 338 last year to solve this problem. The bill would make a permanent – would make permanent the provisions and – this bill would make it permanent.

The legislative debate makes clear that the purpose of IITA § 201(d-1) is to prevent application of retaliatory taxes against Illinois insurance companies. To accomplish that purpose, the Section reduces the Illinois taxes that a foreign insurance company pays in Illinois to the same amount that an Illinois company would pay in the foreign state. Therefore, the application of IITA § 201(d-1) must consider how the foreign state taxes Illinois insurance companies, and not how the foreign state taxes its own insurance companies. The language in IITA § 201(d-1) which adjusts the Illinois rate to zero where no income tax is imposed by the foreign insurer's state of domicile means that the Illinois rate is reduced to zero where the foreign insurer's state of domicile does not impose an income tax on Illinois insurance companies.

For example, Indiana Code § 27-1-20-12 imposes a retaliatory tax where the laws of another state impose taxes on Indiana insurance companies greater than are required under the laws of Indiana. Indiana Code § 6-2.1-8 exempts foreign insurance companies from the Indiana Adjusted Gross Income Tax. Therefore, since Illinois insurance companies do not pay income tax in Indiana, to prevent application of Indiana's retaliatory tax, Indiana insurance companies must be similarly treated for purposes of the Illinois income tax. Accordingly, an Indiana-domiciled foreign insurer should check the box and write zero on Step 2, Line 25 of its 2015 Schedule UB/INS. Of course, the rate reduction remains limited by the provisions of IITA § 201(d-1)(1), which limits the tax reduction to 1.75% of net premiums taxable under Section 409 of the Illinois Insurance Code. This limit is calculated in Step 2 of Schedule INS and Step 3 of Schedule UB/INS.

2. "Privilege Tax" Clarification on Schedules INS and UB/INS

In calculating the IITA § 201(d-1) rate reduction, a taxpayer may try to argue what "privilege tax" amount to use on the Schedules UB/INS or INS from the taxpayer's

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Illinois Privilege Tax Return. The specific line on the Schedules UB/INS and INS is called "The privilege tax imposed under Section 409 of the Illinois Insurance Code" and found under Step 3, Line 28a on the 2015 Schedule UB/INS and under Step 2, Line 7a on the 2015 Schedule INS. The Illinois Privilege Tax return shows a "Privilege Tax Before Credits" and a "Net Privilege Tax". The "Net Privilege Tax" is the privilege tax reduced by fire department taxes, new markets tax credit, and the intergradation offset (the excess of paid Illinois income tax over 1.5% of the net taxable premiums). A taxpayer may try to report the higher "Privilege Tax Before Credits" on the Schedules UB/INS or INS. That is incorrect. The taxpayer should only report the "Net Privilege Tax" on the Schedule INS line for "The privilege tax imposed under Section 409 of the Illinois Insurance Code".

There are several reasons for this. First, Illinois statutes reflected on the Schedules UB/INS and INS line require "The privilege tax imposed under Section 409 of the Illinois Insurance Code". Subsection 409(2) of the Illinois Insurance Code states that the privilege tax is reduced by the following:

> The annual privilege tax payment due from a company under subsection (4) of this Section may be reduced by: (a) the excess amount, if any, by which the aggregate income taxes paid by the company, on a cash basis, for the preceding calendar year under Sections 601 and 803 of the Illinois Income Tax Act exceed 1.5% of the company's net taxable premium written for that prior calendar year, as determined under subsection (1) of this Section; and (b) the amount of any fire department taxes paid by the company during the preceding calendar year under Section 11-10-1 of the Illinois Municipal Code.

These reductions are not called "credits" in the Illinois Insurance Act, but are simply reductions to annual privilege tax paid by insurers. Thus, Section 409 of the Illinois Insurance Act says that the "annual privilege tax payable" is ".5% of the net taxable premium written" reduced by the items shown above.

Second, Schedules UB/INS and INS state that the amounts for privilege tax, fire insurance company taxes, and fire department taxes reported must have been "deducted when you computed this year's federal taxable income". The taxpayer would only deduct the privilege tax paid or payable, which would be the privilege tax reduced by any fire department taxes paid. Doing otherwise would improperly inflate federal deductions.

Third, the fact that Illinois statute and Schedules UB/INS and INS provide a separate line for fire department taxes paid implies that the reported privilege tax should be reduced by fire department taxes paid. Otherwise, the Department would intentionally

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be allowing the fire department taxes paid to count twice toward lowering its reduction floor. The world of taxation rarely double-counts any deduction.

The following examples illustrate the purpose of the reduction floor and properly reporting the privilege tax for purposes of the Schedules UB/INS and INS.

Example 12: The following shows the steps from the Schedule UB/INS to calculate the income tax reduction limit. The first column incorrectly reports the foreign insurer's ("FI's") privilege tax on line 28a. The second column is corrected:

25 Figure the pro forma tax imposed by the foreign insurer member's state or country of domicile, using the income shown on Lines 22 and 23. If the state or country of domicile does not impose an income tax on insurance companies, check the box and enter zero on this line. →	**25**	☒ 0.00	☒ 0.00

Step 3: Figure your foreign insurer member's income tax reduction limit

		Wrong	Right
26 Enter the foreign insurer member's net premiums taxable under Section 409 of the Illinois Insurance Code and included in your Form IL-1120, Step 4, Line 29.	**26**	5,714,286.00	5,714,286.00
27 Multiply Line 26 by 1.75% (.0175). This is the total tax reduction limit.	**27**	100,000.00	100,000.00
28 Enter the following amounts deducted when you computed this year's federal taxable income for the foreign insurer members:			
a The privilege tax imposed under Section 409 of the Illinois Insurance Code. **Do not include retaliatory tax.**	**28a**	30,000.00	21,000.00
b The fire insurance company tax imposed under Section 12 of the Fire Investigation Act.	**28b**	.00	.00
c Any fire department tax imposed under Section 11-10-1 of the Illinois Municipal Code.	**28c**	9,000.00	9,000.00
29 Add Lines 28a through 28c.	**29**	39,000.00	30,000.00
30 Subtract Line 29 from Line 27 (cannot be less than zero). This is the 1.75 percent income tax reduction limit.	**30**	61,000.00	70,000.00

Step 4: Figure your foreign insurer member's tax

31 Enter the foreign insurer member's pro forma tax from Line 25.	**31**	0.00	0.00
32 Enter the foreign insurer member's 1.75 percent income tax reduction limit from Line 30.	**32**	61,000.00	70,000.00
33 Enter the greater of Line 31 or Line 32.	**33**	61,000.00	70,000.00

FI's Line 27 is $100,000 (net premiums taxable times 1.75%). Next, FI's annual privilege tax (paid) is $21,000 and fire department tax is $9,000. FI might try to report $30,000 on 28a (first column), and $9,000 on 28c, for a line 30 of $61,000 ($100,000 - $30,000 - $9,000). By doing so, FI is essentially counting the fire department tax ($9,000) twice.

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The auditor should insist that FI report the annual privilege tax, which is $30,000 reduced by the $9,000, on Line 28a. Following the correct approach (second column), FI would have a higher income tax reduction limit on Line 30 of $70,000 ($100,000 - $21,000 - $9,000). Naturally, taxpayers would like to report the gross privilege tax from their Illinois Privilege Tax Return on Line 28a because it leads to a lower income tax reduction limit and potentially a lower tax.

Example 13: Using the information from Example 12, Foreign Insurer ("FI") would have a pro forma tax on its Illinois income in its home state of $0, but the correct floor (reduction limit) from Example 1 is $70,000. Thus, FI's Illinois total income tax will be reduced to $70,000 (but not $0).

Let's say the pro forma tax had been $85,000, and the floor is still $70,000. FI will then have its Illinois income tax reduced to $85,000 (not the floor of $70,000). We allow the reduction to be to the greater of FI's pro forma tax or the floor.

3. Reinsurance Company Test and Exclusion from IITA § 201(d-1)

Reinsurance companies are not allowed to claim the income tax reduction under IITA § 201(d-1). The statute excludes

> any insurer whose premiums from reinsurance assumed are 50% or more of its total insurance premiums as determined under paragraph (2) of subsection (b) of Section 304, except that for purposes of this determination premiums from reinsurance do not include premiums from inter-affiliate reinsurance arrangements…

So, the determination of a reinsurance company is the same method as for purposes of apportionment under IITA § 304(b)(2), with one difference: reinsurance premiums from affiliates do not count in the 50% test. This is a favorable provision for reinsurers, because some companies that are considered reinsurers for apportionment purposes may not be deemed a reinsurer for IITA § 201(d-1) after removing interaffiliate reinsurance premiums.

For the 50% test under IITA § 304(b)(2), reinsurers include intercompany reinsurance, and then eliminate the intercompany reinsurance premiums for determining the actual apportionment factor. However, the reinsurance test for purposes of the IITA § 201(d-1) rate reduction does not include intercompany reinsurance premiums. The §201(d-1) test still uses the 50% threshold and is performed on a separate company basis like the § 304(b)(2) test. The following examples illustrate this point.

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Example 14: Company RE is an insurance company and member of an Illinois UBG. RE receives $50 million in intercompany reinsurance premiums, $20 million in third-party reinsurance premiums, and $25 million in direct insurance premiums. For purposes of apportionment under IITA § 304(b)(2), RE qualifies as a reinsurance company, because 73.7% ((50+20)/95) of its premiums (intercompany and third-party) comes from reinsurance. However, we disregard the intercompany reinsurance premiums for the IITA § 201(d-1) test. RE would not qualify as a reinsurance company for purposes of the rate reduction, since its eligible reinsurance premiums are only 44.4% (20/45) of total premiums. In this example, RE would apportion as a reinsurance company, but also be eligible for the rate reduction under IITA § 201(d-1).

Example 15: Company RE is an insurance company and member of an Illinois UBG. RE receives $20 million in intercompany reinsurance premiums, $60 million in third-party reinsurance premiums, and $60 million in direct insurance premiums. For purposes of apportionment under IITA § 304(b)(2), RE qualifies as a reinsurance company, because 57.1% ((20+60)/140) of its premiums (intercompany and third-party) comes from reinsurance. However, we disregard the intercompany reinsurance premiums for the IITA § 201(d-1) test. RE would still qualify as a reinsurance company for purposes of the rate reduction, because its eligible reinsurance premiums are 50% (60/120) of total premiums. In this example, RE would apportion as a reinsurance company, and also be an ineligible reinsurance company for the rate reduction under IITA § 201(d-1).

As these two examples illustrate, if a company qualifies as a reinsurance company for IITA § 201(d-1), it will also be a reinsurance company for apportionment purposes. That is because if its third-party reinsurance premiums exceed its direct insurance premiums, then any additional intercompany reinsurance will only increase its reinsurance percentage for the 50% apportionment test under IITA § 304(b)(2). However, if it has intercompany reinsurance business, but its third-party reinsurance is less than its direct premiums, it might qualify as a reinsurance company for apportionment purposes but not under IITA § 201(d-1), making it eligible for the rate reduction.

Again, this provision is favorable for reinsurers who mostly reinsure affiliates, because they can still get the benefit of the IITA § 201(d-1) rate reduction. Other reinsurers with primarily third-party reinsurers will not get the benefit of the rate reduction.

4. Surplus Lines and IITA § 201(d-1)

The language in IITA § 201(d-1) states that the foreign insurer's tax will not be reduced below an amount equal to 1.75% "of the net taxable premiums written for the taxable year, as described by subsection (1) of Section 409 of the Illinois Insurance Code". Surplus line premiums are not subject to premiums tax under Section 409 of the

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Insurance Code. This means that surplus line premiums are included in the apportionment factor under IITA § 304(b), but the surplus line premiums do not count for the IITA § 201(d-1) rate reduction floor. Since a surplus line company has no premiums taxable under Section 409, the 1.75% reduction floor will be zero. See related section at SURPLUS LINE COMPANIES in this Chapter for more information.

5. Schedule UB/INS and GenTax

In cases when the taxpayer is a foreign insurer, the auditor will need to verify that the correct tax amounts are used for Column A of the EDA-25. These taxpayers will file Schedule INS or Schedule UB/INS to adjust the tax that is due to Illinois. For tax years ending on or after December 31, 1999, foreign insurers whose state or country of domicile imposes a retaliatory tax on insurers domiciled in Illinois, are allowed a reduction in the tax rate to the point that the total Illinois tax imposed equals the tax the state or country of domicile would impose on the amount of Illinois net income.

Foreign insurer accounts in GenTax that have converted from Mainframe/Legacy will have the following “Stop Refund” indicator that can be viewed in the Audit Manager shown as follows:

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Additionally, the auditor will be able to see the Review of Foreign Insurer Tax box checked on the return display. This indicates that the taxpayer is a foreign insurer.

When this box is checked the tax shown on the return (Steps 6 and 7) may differ from the tax shown in the total tax figures (Step 8). The totals in GenTax may also be blank when this box is checked due to a conversion issue. See examples of both as follows:

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Example #16

In GenTax the total tax in Steps 6 and 7 differ from the total tax in Step 8.

[redacted]

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[redacted]

[redacted]

To verify the total tax amount, refer to the following Transactions Panel in GenTax for this tax year:

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This panel shows that the converted tax amount on the original return was $477,989.

This can also be verified by looking at the following return detail in Legacy PDF Display:

The total tax is $477,989 and it can be seen that the net replacement tax was adjusted to reflect the foreign insurer tax difference.

When completing an EDA-25 for a foreign insurer, the auditor needs to reflect the adjustment for the foreign insurer in Column A of the EDA-25. Due to the fact that there is no specific line on the EDA-25 for a foreign insurer tax adjustment, the adjustment needs to be entered on the “RT Tax Cr C/F” line in Part III of the EDA-25. To label this line the auditor will need to manually put an asterisk (*) next to the adjustment and then write “*Adj for Sch INS” at the bottom of the EDA-25. Additionally, the auditor needs to note this in the Auditor’s Comments prepared for the audit.

For the example above, the Column A adjustment amount would be $20,062.

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Example #17

In GenTax. Steps 6 and 7 do not agree with the figures in Step 8 as the figures in Step 8 show zero tax. **Note, the screenshots for this example are from an older GenTax version and could not be updated, but the return and transaction screens are very similar to the current version of GenTax.

The total tax is not zero as Step 8 reflects; the total tax is $1,109,442. In cases when the total tax shows as zero and the "Review of Foreign Insurer Tax" box is checked, the auditor will need to verify the total tax amount.

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To verify the total tax amount refer to the following Transactions Panel for this tax year:

This panel shows that the converted tax amount on the original return was $1,109,442.

This can also be verified by looking at the return detail in Legacy PDF Display:

The total tax is $1,109,442 and it can be seen that both the net replacement tax and the net income tax were adjusted to reflect the foreign insurer tax difference.

When completing an EDA-25 for a foreign insurer, the auditor needs to reflect the adjustment for the foreign insurer in Column A of the EDA-25. Due to the fact that there is no specific line on the EDA-25 for a foreign insurer tax adjustment, the adjustment needs to be entered on the “RT Tax Cr C/F” line in Part III of the EDA-25. To label this line the auditor will need to manually put an asterisk (*) next to the adjustment and then write “*Adj for Sch INS” at the bottom of the EDA-25. Additionally, the auditor needs to note this in the Auditor’s Comments.

For the example above, the Column A adjustment amount would be $1,174,784 ($782,269 + $1,501,957 - $1,109,442).

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Foreign insurer accounts in GenTax that originally posted in GenTax:

Foreign insurer adjustment for the net replacement tax is $3,330,820 to $3,224,605 and for the net income tax is $6,395,174 to $4,454,370.

The total tax is $7,678,975 and it can be seen that both the net replacement tax and the net income tax figures were adjusted to reflect the foreign insurer tax difference.

When completing an EDA-25 for a foreign insurer, the auditor needs to reflect the adjustment for the foreign insurer in Column A of the EDA-25. Due to the fact that there is no specific line on the EDA-25 for a foreign insurer tax adjustment, the adjustment needs to be entered on the "RT Tax Cr C/F" line in Part III of the EDA-25. To label this line the auditor will need to manually put an asterisk (*) next to the adjustment and then write "*Adj for Sch INS" at the bottom of the EDA-25. Additionally, the auditor needs to note this in the Auditor's Comments.

For the example above, the Column A adjustment amount would be $2,047,019 ($3,330,820 + $6,395,174 - $7,678,975).

Schedule INS Examples

The following two examples were used in the Captive Insurance WebEx from June 2018 and illustrate two scenarios with a foreign insurer and the Schedule INS. For simplicity, the Schedule INS is used to illustrate how the rate reduction works instead of the Schedule UB-INS. The principle rate reduction works the same for both forms, but the Schedule UB-INS has more complexity by including multiple members and adding three additional steps: determining the foreign insurer's tentative tax, the domestic insurers'

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net income, and the UBG's unitary tax. So, a single foreign insurance company might file a Schedule INS, but a Schedule UB-INS would be used by a UBG composed of insurance companies, at least one or more of whom are domiciled outside of Illinois.

In the following examples, the taxpayer Foreign Captive Insurer (FCI) is a foreign insurance company domiciled in New York filing in TYE 12/15. The Schedule INS is used to determine the rate reduction of IITA § 201(d-1). Their Illinois income tax can be reduced to the pro forma tax they'd pay in their state of domicile on the Illinois income. However, that cannot go lower than the "rate reduction limit", shown by the following computation: (1.75% x net premiums taxable) – (Illinois privilege tax + fire insurance company tax + fire department tax). This calculation is clear on the form. So, the Illinois income tax cannot go below the greater of the pro forma tax and the "rate reduction limit".

In the rare cases where the Illinois tax is lower than the pro forma tax or rate reduction limit, then there is no reduction. That makes sense, because the rate reduction is established to provide relief to foreign insurers from higher Illinois income tax. If their Illinois tax is already lower than what they would pay in their home state, there is no need for tax relief.

Example A: Foreign Captive Insurer ("FCI") does not qualify for a rate reduction. FCI's tentative Illinois tax of $53,785. However, any reductions cannot make it go lower than the greater of the pro forma tax ($13,880) and the rate reduction limit ($242,173), so FCI does not qualify for a rate reduction.

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Use your mouse or Tab key to move through the fields. Use your mouse or space bar to enable check boxes.

Illinois Department of Revenue

Schedule INS

Tax for Foreign Insurers

Attach to your Form IL-1120. **This schedule is for tax years ending on or after December 31, 2015.**

Year ending 12 (Month) 2015 (Year)

IL Attachment No. 7

Enter your name as shown on your Form IL-1120: Foreign Captive Insurer ("No Reduction")

Enter your federal employer identification number (FEIN): 12-3456789

Step 1: Figure the tax imposed by your state or country of domicile

Note → You must complete Steps 1 through 7 of your Form IL-1120 before completing this schedule.

1	Enter your state or country of domicile.	1	New York
2	Enter the base income from your Form IL-1120, Line 23.	2	6,122,168.00
3	Enter the net income from your Form IL-1120, Line 39.	3	693,997.00
4	Compute the pro forma tax imposed by your state or country of domicile using the income shown on Lines 2 and 3. If your state or country of domicile does not impose an income tax on insurance companies, check the box and enter zero on this line. → ☐	4	13,880.00 ←Pro forma tax

Note → The pro forma tax for Line 4 is the total of all tax measured by net income, less credits, imposed by your state or country of domicile, on an insurance company with base income (before apportionment) equal to Line 2 and net income (after apportionment) equal to Line 3. If you did not check the box on Line 4, attach completed copies of all forms necessary to support the computation of this amount.

Step 2: Figure your income tax reduction limit

5	Enter the net premiums taxable under Section 409 of the Illinois Insurance Code and included in your Form IL-1120, Step 4, Line 29.	5	19,973,847.00
6	Multiply Line 5 by 1.75 percent (.0175). This is your total tax reduction limit.	6	349,542.00
7	Enter the following amounts deducted when you computed this year's federal taxable income:		
	a The privilege tax imposed under Section 409 of the Illinois Insurance Code. **Do not include retaliatory tax.**	7a	99,869.00
	b The fire insurance company tax imposed under Section 12 of the Fire Investigation Act.	7b	5,000.00
	c Any fire department tax imposed under Section 11-10-1 of the Illinois Municipal Code.	7c	2,500.00
8	Add Lines 7a through 7c.	8	107,369.00
9	Subtract Line 8 from Line 6. (If the amount is negative, enter "0.") This is your 1.75 percent income tax reduction limit. Enter here and on Line 14.	9	242,173.00 ←1.75% Reduction limit

Step 3: Figure your tax

10	Enter the replacement tax from your Form IL-1120, Line 44.	10	17,350.00
11	Enter the income tax from your Form IL-1120, Line 49.	11	36,435.00
12	Add Lines 10 and 11. This is your tentative tax.	12	53,785.00 ←Orig. I/T
13	Enter the amount of pro forma tax from Line 4.	13	13,880.00
14	Enter the 1.75 percent income tax reduction limit from Line 9.	14	242,173.00
15	Enter the greater of Line 13 or Line 14.	15	242,173.00 ←Greater of pro forma or 1.75% limit: FLOOR

STOP **If Line 15 is greater than Line 12, you are not entitled to a tax reduction. Do not use this schedule.**

16	Enter the lesser of Line 10 or Line 15.	16	17,350.00
16a	Subtract Line 16 from Line 10. This is your replacement tax reduction. Enter this amount on Form IL-1120, Step 8, Line 50a.	16a	0.00
17	If Line 15 is greater than Line 16, subtract Line 16 from Line 15. Otherwise, enter zero. This is your maximum net income tax after applying credits.	17	224,823.00
18	Enter the lesser of Line 11 or Line 17.	18	36,435.00
18a	Subtract Line 18 from Line 11. This is your income tax reduction. Enter this amount on Form IL-1120, Step 8, Line 51a.	18a	0.00

Schedule INS (IL-1120) (R-12/15)

This form is authorized as outlined by the Illinois Income Tax Act. Disclosure of this information is REQUIRED. Failure to provide information could result in a penalty.

Reset Print

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Example 2: Here, Foreign Captive Insurer ("FCI") does qualify for a rate reduction. FCI's tentative Illinois tax of $53,785. It cannot go lower than the greater of the pro forma tax ($13,880) and the rate reduction limit ($34,750). That means FCI's tentative tax will be reduced to $34,750. The rate reduction first applies to income tax, and then replacement tax if income tax is reduced to $0. In this example, FCI's income tax is reduced by $19,035, so that FCI's reduced income tax ($17,400) plus replacement tax ($17,350) equals $34,750. This is shown mechanically on the form below:

Use your mouse or Tab key to move through the fields. Use your mouse or space bar to enable check boxes.

Illinois Department of Revenue
Schedule INS — **Tax for Foreign Insurers**
Attach to your Form IL-1120. **This schedule is for tax years ending on or after December 31, 2015.**
Year ending 12 (Month) 2015 (Year)
IL Attachment No. 7

Enter your name as shown on your Form IL-1120.: Foreign Captive Insurer ("Reduction")
Enter your federal employer identification number (FEIN).: 1 2 - 3 4 5 6 7 8 9

Step 1: Figure the tax imposed by your state or country of domicile

Note: You must complete Steps 1 through 7 of your Form IL-1120 before completing this schedule.

1	Enter your state or country of domicile.	1	New York
2	Enter the base income from your Form IL-1120, Line 23.	2	6,122,168.00
3	Enter the net income from your Form IL-1120, Line 39.	3	693,997.00
4	Compute the pro forma tax imposed by your state or country of domicile using the income shown on Lines 2 and 3. If your state or country of domicile does not impose an income tax on insurance companies, check the box and enter zero on this line. → ☐	4	13,880.00 ←Pro forma tax

Note: The pro forma tax for Line 4 is the total of all tax measured by net income, less credits, imposed by your state or country of domicile, on an insurance company with base income (before apportionment) equal to Line 2 and net income (after apportionment) equal to Line 3. If you did not check the box on Line 4, attach completed copies of all forms necessary to support the computation of this amount.

Step 2: Figure your income tax reduction limit

5	Enter the net premiums taxable under Section 409 of the Illinois Insurance Code and included in your Form IL-1120, Step 4, Line 29.	5	3,000,000.00
6	Multiply Line 5 by 1.75 percent (.0175). This is your total tax reduction limit.	6	52,500.00
7	Enter the following amounts deducted when you computed this year's federal taxable income:		
	a The privilege tax imposed under Section 409 of the Illinois Insurance Code. **Do not include retaliatory tax.**	7a	15,000.00
	b The fire insurance company tax imposed under Section 12 of the Fire Investigation Act.	7b	2,000.00
	c Any fire department tax imposed under Section 11-10-1 of the Illinois Municipal Code.	7c	750.00
8	Add Lines 7a through 7c.	8	17,750.00
9	Subtract Line 8 from Line 6. (If the amount is negative, enter "0.") This is your 1.75 percent income tax reduction limit. Enter here and on Line 14.	9	34,750.00 ←1.75% Reduction limit

Step 3: Figure your tax

10	Enter the replacement tax from your Form IL-1120, Line 44.	10	17,350.00
11	Enter the income tax from your Form IL-1120, Line 49.	11	36,435.00
12	Add Lines 10 and 11. This is your tentative tax.	12	53,785.00 ←Orig. I/T
13	Enter the amount of pro forma tax from Line 4.	13	13,880.00
14	Enter the 1.75 percent income tax reduction limit from Line 9.	14	34,750.00
15	Enter the greater of Line 13 or Line 14.	15	34,750.00 ←Greater of pro forma or 1.75% limit: FLOOR

If Line 15 is greater than Line 12, you are not entitled to a tax reduction. Do not use this schedule.

16	Enter the lesser of Line 10 or Line 15.	16	17,350.00
16a	Subtract Line 16 from Line 10. This is your replacement tax reduction. Enter this amount on Form IL-1120, Step 8, Line 50a.	16a	0.00
17	If Line 15 is greater than Line 16, subtract Line 16 from Line 15. Otherwise, enter zero. This is your maximum net income tax after applying credits.	17	17,400.00
18	Enter the lesser of Line 11 or Line 17.	18	17,400.00
18a	Subtract Line 18 from Line 11. This is your income tax reduction. Enter this amount on Form IL-1120, Step 8, Line 51a.	18a	19,035.00

Schedule INS (IL-1120) (R-12/15) FOOTER

This form is authorized as outlined by the Illinois Income Tax Act. Disclosure of this information is REQUIRED. Failure to provide information could result in a penalty.

Reset Print

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F. FEDERAL LIMITATIONS ON LOSSES OF CERTAIN CONSOLIDATED GROUPS

IRC § 1504(c)(2) provides an election whereby certain life insurance companies can be treated as includible corporations, and thus members, of a group composed of other includible non-life corporations. This section of the IRC allows certain life insurance companies to file a consolidated life/non-life return with the IRS. This provision is effective for taxable years for which the due date (without extensions) for filing returns is after March 14, 1983.

In the case of a consolidated group of corporations which has made an election under IRC § 1504(c)(2), IRC § 1503(c) imposes limitations on the group's ability to use losses incurred by the non-life insurance companies to offset income earned by the life insurance company members.

To oversimplify the limitations contained in IRC § 1503(c), the non-life members' losses may offset the lesser of (i) 35% of the life insurance company members' income or (ii) 35% of the non-life members' loss. Moreover, no loss of a non-life member may be used to offset income of a life insurance company until the two have been affiliated for more than five years. These rules apply to both current losses and carryover losses, and require very complicated implementation rules under 26 CFR § 1.1502-47.

1. Application To Illinois

IITA § 203(e)(2)(E) requires a corporation that joins in the filing of a consolidated federal income tax return to compute its Illinois taxable income by starting with federal taxable income computed as if it had always filed separate company federal returns. If the corporation is a member of a unitary business group, IITA § 304(e) and IAC § 100.3320(e) then require it and its affiliates to use the combined apportionment method to determine the group's Illinois taxable income.

From 1985 through 1992, a unitary business group could elect "to be treated as one taxpayer" under IITA § 502(e). For years ending on or after December 31, 1993, IITA § 502(e) provides that, "members of the same unitary business group shall be treated as one taxpayer for purposes of any original return…and determination of the group's tax liability under this Act." (Emphasis added.) (See also IITA § 1501(a)(27) for definition of unitary group.)

Pursuant to IITA § 502(e), the Department promulgated regulations that adopt the federal consolidated return regulations for guidance in determining the "one taxpayer"

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taxable income of a unitary business group. However, several consolidated return regulation provisions, including the federal limitation on losses of life and non-life groups, are not consistent with treating the members of a unitary business group as if they were one taxpayer. Accordingly, IAC § 100.5270(a) provides that the members of a unitary business group must compute their combined base income "as if they constituted a federal consolidated group and by applying the federal regulations for determining consolidated taxable income, except that the separate return limitation year provisions and the limitations on consolidation of life and non-life companies in Treasury Reg. Section 1.1502-47 shall not apply."

Accordingly, neither the IITA nor the regulations incorporate the IRC § 1503(c) limitations, and those limitations SHOULD BE ignored in the computation of combined Illinois taxable income of a unitary business group.

G. ILLINOIS TAXATION OF REINSURANCE COMPANIES

Reinsurance is the process whereby a company may share its risk with other companies by paying a portion of the premiums it receives. For example, when Company A assumes insurance from Company B, this is called reinsurance.

If the principal source of premiums written by an insurance company consists of premiums for reinsurance accepted, the insurance company is considered to be a reinsurance company and is required to apportion its income under IITA § 304(b)(2).

1. Test For Reinsurance Companies

In order to qualify as a reinsurance company, the principal source of premiums (over 50%) written by an insurance company must be for reinsurance accepted. For a unitary group, this test is conducted on a company by company basis. REF: Minutes from Legal/TSS meeting of September 25, 1997. Intercompany transactions will not be eliminated for the purposes of conducting this test (consistent with the 80/20 test in IAC § 100.9700(c)). They will be eliminated, however, in the computation of the apportionment factor. (See discussion at Total Premiums Everywhere below.)

If unitary, regular insurance companies which are required to apportion their income under IITA § 304(b)(1) and reinsurance companies required to apportion their income under IITA § 304(b)(2) MUST be included in the same unitary group.

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Example #18

Insurance Company B has total direct premiums written of $10 million and has reinsurance assumed of $15 million. B is not owned by any other corporation nor does it have any subsidiaries. In this case, B would be treated as a reinsurance company and required to apportion its income under IITA § 304(b)(2) because more than 50% of its total premiums are from reinsurance assumed.

Example #19

For the year ending December 31, 1990, insurance companies C and D filed separate unitary returns. C has total direct premiums of $10 million and has reinsurance assumed from unrelated third parties of $15 million. D has total direct premiums of $20 million and reinsurance assumed of $1 million from unrelated third parties. In this case, C would be treated as a reinsurance company and required to calculate its denominator under IITA § 304(b)(2) because more than 50% of its total premiums are from reinsurance assumed. D would be treated as a regular insurance company and required to calculate its denominator under IITA § 304(b)(1). The numerator of the apportionment formula would be determined using IITA § 304(b)(2) for C and IITA § 304(b)(1) for D.

Example #20

For the year ending December 31, 1992, insurance companies E and F made an election to file a combined return. E had total direct premiums of $10 million and reinsurance assumed of $15 million ($3 million from unrelated third parties and $12 million from F). F had total direct premiums of $20 million and reinsurance assumed from unrelated third parties of $5 million. In this case, E would be treated as a reinsurance company and required to calculate its denominator under IITA § 304(b)(2) because more than 50% of its total premiums are from reinsurance assumed. F would be treated as a regular insurance company and required to calculate its denominator under IITA § 304(b)(1). The numerator of the apportionment formula would be determined using IITA § 304(b)(2) for E and IITA § 304(b)(1) for F.

Example #21

For the year ending December 31, 1995, insurance companies G and H filed a combined return. G had total direct premiums of $10 million and had reinsurance assumed of $50 million from unrelated third parties. H had total direct premiums of $20 million and reinsurance assumed of $10 million from unrelated third parties. In this case, G would be treated as a reinsurance company and required to calculate its denominator under IITA § 304(b)(2) because more than 50% of its total premiums are from

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reinsurance assumed. H would be treated as a regular insurance company and required to calculate its denominator under IITA § 304(b)(1). The numerator of the apportionment formula would be determined using IITA § 304(b)(2) for G and IITA §304(b)(1) for H.

2. Factor Numerator For A Reinsurance Company

For taxable years ending on or after December 31, 2008, if more than 50% of a company's premiums written are for reinsurance accepted, then the numerator of the factor is:

- Direct premiums written for insurance upon property or risk in Illinois, plus
- Premiums written for reinsurance accepted for property or risk in Illinois

The denominator of the factor is the sum of the direct premiums written for insurance on property or risk everywhere plus premiums written for reinsurance accepted for property or risk everywhere. REF: IITA § 304(b)(2).

Premiums written for reinsurance accepted with respect to property or risk in Illinois, whether or not otherwise determinable, may, at the election of the company,

(1) Be determined on the basis of the proportion of premiums written for reinsurance accepted from companies commercially domiciled in Illinois bears to premiums written for reinsurance accepted from all sources, or, alternatively,

(2) in the proportion which the sum of the direct premiums written for insurance upon property or risk in this State by each ceding company from which reinsurance is accepted bears to the sum of the total direct premiums written by each such ceding company for the taxable year. (IITA § 304(b)(2) and IAC § 100.3420(e)(2))

The taxpayer could change this election at any time under IAC § 100.3420(e)(3). However, under PA 97-0507 the election made for the first taxable year ending on or after December 31, 2011 is binding for all subsequent taxable years, unless altered by written permission from the Department.

Note: PA 95-233 had terminated reinsurance companies' right to elect one of the three methods to source reinsurance premiums for tax years ending on or after December 31, 2008. PA 97-0507 reinstated for all taxable years the option to elect one of the three sourcing methods. Therefore, under certain circumstances the taxpayer could become overpaid if it originally applied the method required by

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PA 95-233 and subsequently choose another reapportionment method on an amended return or during audit.

a) Total Premiums Everywhere

The information necessary to calculate the denominator of the apportionment factor for a reinsurance company can be found in the Annual Statement filed with the Illinois Director of Insurance. The denominator of the apportionment factor will consist of:

- The total direct premiums everywhere plus;
- The total reinsurance assumed.

In situations where a reinsurance company assumes insurance from another member of the unitary group, the transaction(s) should be treated as an intercompany elimination for purposes of calculating the denominator of the apportionment factor under IITA § 304(b). Since the gross profit from intercompany transactions is eliminated from federal taxable income and Illinois base income, intercompany premiums would not be included in the apportionment factor under IAC § 100.3420(c)(1).

If the reinsurance company files an Annual Statement for property and casualty companies, the total direct premiums everywhere should be calculated in the same manner as for property and casualty companies. The total reinsurance assumed is the total of the reinsurance assumed from affiliates and from non-affiliates reported in Columns 2 and 3, respectively, of Underwriting and Investment Exhibit (Part 1b Premiums Written) of the Annual Statement.

If the reinsurance company files an Annual Statement for life insurance companies, the total direct premiums everywhere should be calculated in the same manner as for life insurance companies. The total reinsurance assumed is reported on Line 96 (Columns 2 through 4) of Schedule T of the Annual Statement.

The column, line, and schedule references used above are for the 2008 Annual Statement. The format and line numbers for this premium information may be different in other years.

The following examples explain how the denominator of the apportionment formula should be computed. The numerator of the formula will be discussed in the next section.

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Example #22

Insurance companies C and D filed separate unitary returns. C has total direct premiums of $10 million and has reinsurance assumed from unrelated third parties of $15 million. D has total direct premiums of $20 million and reinsurance assumed of $1 million from unrelated third parties. C is a reinsurance company and required to calculate its denominator under IITA § 304(b)(2) because more than 50% of its total direct premiums are from reinsurance assumed. D is a regular insurance company and required to calculate its denominator under IITA § 304(b)(1). The denominator for the insurance factor for the unitary group would be $45 million (C- $25 million plus D- $20 million). (Note: Combined returns are required for tax years ending on or after December 31, 1993).

Example #23

For the year ending December 31, 1992, insurance companies E and F made an election to file a combined unitary return. E had total direct premiums of $10 million and reinsurance assumed of $15 million ($3 million from unrelated third parties and $12 million from insurance company F). F had total direct premiums of $20 million and reinsurance assumed from unrelated third parties of $5 million. E is a reinsurance company and required to calculate its denominator under IITA § 304(b)(2) because more than 50% of its total direct premiums are from reinsurance assumed. F is a regular insurance company and required to calculate its denominator under IITA § 304(b)(1). The denominator for the insurance factor for the unitary group would be $33 million (E- $13 million plus F- $20 million). (Note: Combined returns are required for tax years ending on or after December 31, 1993).

Example #24

For the year ending December 31, 2010, insurance companies G and H filed a combined unitary return. G has total direct premiums of $10 million and had reinsurance assumed of $50 million from unrelated third parties. H has total direct premiums of $20 million and reinsurance assumed of $10 million from unrelated third parties. G is a reinsurance company and required to calculate its denominator under IITA § 304(b)(2) because more than 50% of its total direct premiums are from reinsurance assumed. H is a regular insurance company and required to calculate its denominator under IITA § 304(b)(1). The denominator for the insurance factor for the unitary group would be $80 million (G- $60 million plus H- $20 million).

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b) Illinois Premiums

IITA § 304(b)(2) allows three different methods for calculating the amount of reinsurance assumed that is included in the Illinois premiums for a reinsurance company. They will be referred to as methods A, B, and C.

The taxpayer can elect to use any of the three methods. For tax years ending on or after December 31, 2011, the election will be binding unless the taxpayer is granted written permission from the Department. This means that the election is not irrevocable for any tax year. For tax years ending before December 31, 2011, the taxpayer may choose method A on their original return and elect to use method B on an amended return or during an audit. This would also be possible for subsequent tax years, although the taxpayer will have to secure written permission from the Department first. Each separate reinsurance company makes the election in a unitary group regardless of whether separate unitary, elective combined or mandatory combined returns are filed.

The three methods which may be used to determine the amount of reinsurance premiums assumed in Illinois are the following:

Method A

Premiums written for reinsurance accepted in respect of property or risk in this State, and premiums written for reinsurance accepted in respect of property or risk everywhere;

Method B

Premiums written for reinsurance accepted from companies commercially domiciled in this State, and premiums written for reinsurance accepted from companies everywhere; and

Method C

Direct premiums written for insurance upon property or risk in this State by each ceding company from which reinsurance is accepted, and direct premiums written for insurance upon property or risk everywhere by each ceding company from which reinsurance is accepted.

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In all three methods:

1. The first step in calculating the apportionment formula for a reinsurance company is to determine the total direct premiums written everywhere and the total reinsurance assumed.

2. If the company is required to file as a member of a unitary group, any reinsurance assumed from another group member should be identified and eliminated.

3. Illinois direct premiums should be verified using Schedule T.

4. The method the company used to calculate its Illinois reinsurance assumed should be determined and the amount verified from its books and records. The amount of Illinois reinsurance assumed cannot be verified from Schedule T and Annual Report.

The direct premiums and the reinsurance assumed should be combined to arrive at one percentage rather than computing an average of the percentage for direct premiums and reinsurance assumed.

Example #25

For the year ending December 31, 1990, insurance companies B, C, and D filed separate unitary returns. Companies B and C qualify as reinsurance companies and are required to apportion their income under IITA § 304(b)(2). Company B can choose method A and company C can choose method B to determine their reinsurance premiums assumed in Illinois.

Example #26

For the year ending December 31, 2010, insurance companies E, F, and G file a combined return. Companies F and G qualify as reinsurance companies and are required to apportion their income under IITA § 304(b)(2). Company F can choose method B and company G can choose method C to determine their reinsurance premiums assumed in Illinois.

Example #27

For the year ending December 31, 2011, insurance companies H, I, and J filed a combined return. Companies I and J qualify as reinsurance companies and are required to apportion their income under IITA § 304(b)(2). Company I can choose

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method A and Company J can choose method C to determine their reinsurance premiums assumed in Illinois. The methods chosen will be binding for each company to use in subsequent returns, until written permission is granted from the Department to use another reinsurance apportionment method.

Example #28

Reinsurance Company B files a separate return and elects to compute its Illinois premiums assumed in Illinois under method A. The review of Schedule T shows that B had total direct premiums everywhere of $30 million and Illinois direct premiums of $15 million. B had total reinsurance assumed of $70 million. B elects method A to apportion its reinsurance assumed. B provided detailed information showing that of the $70 million of reinsurance assumed that $10 million of the total was for property or risk in Illinois. In calculating the apportionment factor for B, the total premiums everywhere would be $100 million ($70 million plus $30 million) and the total Illinois premiums would be $25 million ($15 million plus $10 million).

Example #29

For the year ending December 31, 2012, insurance companies B, C, and D filed a combined return. C and D are reinsurance companies. B has direct premiums everywhere of $50 million, Illinois direct premiums of $5 million, and reinsurance assumed from unrelated third parties of $5 million. C has no direct premiums and reinsurance assumed of $70 million ($30 million from B and D and $40 million from an unrelated third party which is commercially domiciled in California). C elects method B to apportion its reinsurance assumed. D has $10 million in total direct premiums, $2 million in Illinois direct premiums, and $50 million in reinsurance assumed from an unrelated third party which is commercially domiciled in Illinois. D provided detailed information showing that of the $50 million of reinsurance assumed that $8 million of the total was for property or risk in Illinois. D elects method A to apportion its reinsurance assumed. In calculating the apportionment factor for the unitary group, the total premiums everywhere would be $150 million (B- $50 million in direct premiums, C- $40 million in reinsurance assumed ($70 million less the intercompany elimination of $30 million), D- $60 million ($10 million in direct premiums plus $50 million in reinsurance assumed)). The total Illinois premiums would be $15 million (B- $5 million in Illinois direct premiums, C- $0 in Illinois reinsurance assumed, D- $2 million Illinois direct premiums and $8 million in Illinois reinsurance assumed. The reinsurance apportionment methods chosen by C and D are binding in subsequent years until written permission is granted by the Department to elect another method.

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Example #30

Reinsurance Company A files a separate return and elects to compute its Illinois premiums assumed in Illinois under method C. The review of Schedule T shows that A had total direct premiums everywhere of $30 million and Illinois direct premiums of $15 million. A had total reinsurance assumed of $30 million from company ABC (an unrelated company) and $40 million from company XYZ (an unrelated company). A elects method C to apportion its reinsurance assumed. A provided copies of the Schedule T for companies ABC and XYZ showing that the ratio of direct premiums on property or risk located in Illinois to total direct premiums is 10% for ABC and 25% for XYZ. In calculating the apportionment factor for A, the total premiums everywhere would be $100 million ($70 million in reinsurance assumed plus $30 million in direct premiums) and the total Illinois premiums would be $28 million ($15 million in Illinois direct premiums plus $3 million in reinsurance assumed from ABC plus $10 million in reinsurance assumed from XYZ).

H. MUTUAL COMPANIES

As originally enacted in 1969, the purpose of IITA § 203(e)(2)(B) was to define taxable income for mutual insurance companies. In 1969, IITA § 203(e)(2)(B) stated:

> Certain mutual insurance companies. In the case of a mutual insurance company subject to the tax imposed by Section 821(a) or (c) of the Internal Revenue Code, mutual insurance company taxable income or taxable investment income, as the case may be.

Section 203(b)(1) defined base income as “an amount equal to the taxpayer’s taxable income for the taxable year as modified by section 203(b)(2).

Prior to the Tax Reform Act of 1986, mutual insurance companies were subject to tax under IRC § 821, and all other non-life insurance companies were subject to tax under IRC § 831. In 1986, IRC § 821 was repealed and all non-life insurance companies became subject to IRC § 831.

In 1987, Pubic Act 85-731, amended IITA § 203(e)(2)(B) to state that, “Certain other insurance companies. In the case of mutual insurance companies subject to the tax imposed by IRC § 831, insurance company taxable income.” The reference to mutual companies in the amended version of IITA § 203(e)(2)(B) is a drafting error in the statute. This section was intended to define the taxable income for all insurance companies subject to IRC § 831.

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Like other insurance companies, mutual companies are required to file an Annual Statement with the Illinois Department of Insurance. For information concerning the modifications and apportionment formula for mutual companies, refer to the prior sections of this Chapter dealing with life insurance and property and casualty companies at Casualty Companies (Fire, Marine, And Auto) and Life Insurance Companies.

1. Years Ending On Or After December 31, 1986 To Current

For the years ending on or after December 31, 1986, all mutual insurance companies except for mutual life insurance companies are required to file a federal Form 1120-PC return. Most mutual insurance companies will calculate their federal taxable income using Schedule A of Form 1120-PC. The federal taxable income calculated on Schedule A is reported on line one of page one of Form 1120-PC.

If a mutual company is a small company as defined by IRC § 831(b)(2) and makes the election under IRC § 831(b)(2)(A)(ii) to be taxed on taxable investment income, it will complete Schedule B of federal Form 1120-PC. This provision allows mutual and stock companies with net written premiums or direct written premiums (whichever is greater) in excess of $350,000 but less than $1,200,000 to elect to be taxed only on taxable investment income. To determine the amount of direct or net written premiums of a member of a controlled group of corporations, the direct or net written premiums of all members of the controlled group are aggregated. The federal taxable income calculated on Schedule B is reported on line two of page one of the Form 1120-PC. Once a company elects to be taxed on taxable investment income, it must continue to be so taxed (as long as it qualifies) unless the Secretary of the Treasury consents to the revocation of the election.

2. Years Ending Prior To December 31, 1986

For the years ending on or before December 31, 1986, mutual companies except for life, marine, and certain fire insurance companies filed federal Form 1120M returns. In arriving at mutual insurance company taxable income, the federal Form 1120M combined taxable income (loss), underwriting income (loss), and the Protection Against Loss (PAL) account and subtracted from this total the unused loss deduction.

For years ending on or before December 31, 1986, mutual property and casualty insurance companies were permitted a deduction for contributions (which are bookkeeping entries) to PAL account. The amount of the deduction was equal to the sum of 1% of the underwriting losses for the year plus 25% of statutory underwriting income, plus certain windstorm and other losses. In general, contributions to the PAL

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account were taken in income after a 5-year period. The PAL account thus effected a 5-year deferral of a portion of mutual company underwriting income.

The purpose of the PAL provision had been to provide mutual companies with a source of capital to enable them to compete with stock companies, in the event of a catastrophic loss. While stock companies could enter capital markets and issue new stock to raise money in the event of a catastrophic loss, a mutual company could not do so. The five-year partial income deferral provided a source of capital not available to stock companies. This provision has been repealed for years ending after December 31, 1986.

I. SURPLUS LINE COMPANIES

Surplus line insurance is defined as insurance on an Illinois risk procured from an unauthorized company (a surplus line insurance company) after the insurance producer representing the insured or the surplus line producer is unable, after diligent effort, to procure insurance from companies which are authorized to transact business in Illinois.

A surplus line insurance company is an insurance company which is allowed to insure Illinois property with surplus line insurance in certain circumstances but which is:

1. Not authorized by the Department of Insurance to do business directly in Illinois;

2. Not subject to regulation by the Department of Insurance;

3. Not subject to direct Privilege Tax on the premiums they receive; and

4. Is exempt from the requirement imposed on authorized companies to file Annual Statements with the Illinois Director of Insurance.

A "surplus line producer" is an insurance agent that is permitted to sell policies on behalf of surplus line companies when the agent cannot obtain a policy from a company authorized to do business in Illinois. Each surplus line producer must file semi-annual reports with the Director of Insurance and pay a tax equal to 3% of the premiums paid to surplus line companies through the producer. The producer must file copies of each surplus line contract with the Surplus Line Association of Illinois and make certain disclosures to an insured party about the surplus line company issuing a policy. (Section 445 of the Insurance Code).

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1. Description Of Surplus Line Insurance Transaction

A typical surplus line insurance transaction can be described as follows:

- An Illinois insured's property or risk is unable to be insured by any admitted carrier (an insurance carrier authorized to do business in Illinois);
- A surplus line producer that is licensed and regulated by the Department of Insurance obtains written confirmation of denial of coverage by admitted insurers;
- A surplus line carrier writes the policy;
- The insured pays premiums to the surplus line producer;
- The producer deducts commissions and surplus line taxes from the premium payments and makes payments to the surplus line insurer;
- All surplus line insurance transactions are reported to the Department of Insurance through a semiannual filing by the surplus line producer; and
- The surplus line producers make monthly filings of the substance of each surplus line policy transaction to the Surplus Line Association of Illinois.

The Department's current policy is that surplus line premiums are included in the premiums numerator under IAC § 100.3420(d).

2. June 27, 1997 Policy

In 1996, Director Zehnder issued a Director's Decision (this cleansed decision is listed as case IT 96-11 on the Department's website) in a hearing dealing with a surplus line insurance company. The audit was completed in accordance with the 1990 policy.

On June 27, 1997, as a result of Director Zehnder's decision in the above hearing, the Department's policy on surplus line companies was revised as follows:

- If unitary, a surplus line company SHOULD be included in the same unitary group with other related insurance companies;
- The total premiums everywhere for the surplus line company SHOULD be included in the denominator of the apportionment factor; and

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- The Illinois premiums of the surplus line company SHOULD BE included in the numerator of the apportionment factor.

In implementing this new position, the Audit Bureau will ONLY issue a Notice of Deficiency against an open tax year that has NOT been previously audited by the Department. In the rare instance where this change in policy results in a claim for credit, the Audit Bureau will approve claims for credit for ALL open tax years regardless of whether or not those years have been previously audited by the Department. The auditor should be aware that in some circumstances a nonfiler may be entitled to abatement of tax under the six-year reasonable cause guidelines in UPIA § 3-10.

3. 1990 Policy

In 1990, the Legal Services Bureau developed the following policy for surplus line companies:

- If unitary, a surplus line company SHOULD be included in the same unitary group with other related insurance companies;
- The total premiums everywhere for the surplus line company SHOULD be included in the denominator of the apportionment factor; and
- The Illinois premiums of the surplus line company SHOULD NOT be included in the numerator of the apportionment factor.

Example #31

In March, 1997, the taxpayer signed an IL-870 and paid a deficiency of $100,000 for the tax years ending December 31, 1994 and December 31, 1995. The audit is currently in Technical Review and the reviewer notes that the Illinois premiums for the surplus line company were not included in the Illinois premiums for the combined return. Since the taxpayer signed the IL-870 prior to the effective date (June 27, 1997) of AMU 97-9, no adjustment will be made to the audit for the Illinois premiums for the surplus line company.

Example #32

In April 1997, a closing conference was held with the taxpayer for the years ending December 31, 1994 and December 31, 1995. The taxpayer disagreed with the proposed deficiency of $200,000. The audit is currently in Technical Review and the reviewer

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notes that the Illinois premiums for the surplus line company were not included in the Illinois premiums for the combined return. Since a closing conference was held with the taxpayer prior to the effective date (June 27, 1997) of AMU 97-9, no adjustment will be made to the audit for the Illinois premiums for the surplus line company.

Example #33

In 1990, the Department was auditing a group of insurance companies that had filed combined returns for the years ending December 31, 1987 and December 31, 1988. The combined returns included the income and denominator for a surplus line company. Based on AMU 90-3, the auditor did not include the numerator of the surplus line company in the unitary group. In addition, the auditor had noted that for the years ending prior to December 31, 1987, all of the regular insurance companies had filed separate returns and that the surplus line company was a nonfiler. Based on AMU 90-3, the auditor advised the taxpayer that no liability was due for the years ending December 31, 1987 and December 31, 1988 and that the surplus line company had no tax liability for all years prior to December 31, 1987. On December 20, 1990, the taxpayer signed an IL-870 and paid a deficiency of $300,000.

For the years ending after December 31, 1988 and prior to December 31, 1993, the taxpayer filed combined returns. For these years, the taxpayer included the surplus line company in the unitary group, included the total premiums everywhere of the surplus line company in the denominator of the apportionment factor, and did not include the Illinois premiums of the surplus line company in the numerator of the combined returns. An audit covering the years ending December 31, 1993 and December 31, 1994 is currently in process.

Since the years were previously audited and/or the statute of limitations has now expired for the years, no notice of deficiency will be issued for ANY year ending prior to December 31, 1993. The Department's new position will be implemented in the audit that is currently in process for the years ending December 31, 1993 and December 31, 1994.

Example #34

An audit is currently in process on a group of insurance companies for the years ending December 31, 1993 and December 31, 1994. The auditor determines that the Illinois premiums for the surplus line company were not included in the Illinois premiums for the combined returns for the years ending December 31, 1993 and December 31, 1994. The Department's new position will be implemented for the years ending December 31, 1993 and December 31, 1994.

The auditor determined that this group of insurance companies has never been audited

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by the Department.

For the year ending December 31, 1992, the surplus line company was included in the combined return filed by the taxpayer. The taxpayer included the total premiums everywhere for the surplus line company in the denominator of the apportionment factor but did not include the Illinois premiums of the surplus line company in the numerator of the apportionment factor. Since the statute of limitations has expired for the year ending December 31, 1992, no adjustment can be made to this year.

For the year ending December 31, 1991, all of the insurance companies except for the surplus line company filed separate unitary returns. The surplus line company was not included in the unitary group and did not file a return for this year. A Notice of Deficiency can be issued against the surplus line company for this year.

For all of the years ending prior to December 31, 1991, all of the insurance companies except for the surplus line company filed separate returns. The surplus line company did not file returns for any year prior to December 31, 1991. A Notice of Deficiency can be issued against the surplus line company for all years in which they had Illinois premiums.

The auditor should be aware that in some circumstances a nonfiler may be entitled to abatement of tax under the six year reasonable cause guidelines in UPIA § 3-10.

As stated above, surplus line companies are exempt from the requirement imposed on authorized companies to file Annual Statements with the Illinois Director of Insurance. However, the surplus line companies will file an Annual Statement with the Director of Insurance in the state of their commercial domicile. Schedule T from this Annual Statement can be used to obtain the apportionment data for the surplus line companies.

In summary, the Audit Bureau's current policy for surplus line companies is:

- If unitary, a surplus line company SHOULD be included in the same unitary group with other related insurance companies;
- The total premiums everywhere for the surplus line company SHOULD be included in the denominator of the apportionment factor; and
- The Illinois premiums of the surplus line company SHOULD be included in the numerator of the apportionment factor under IAC § 100.3420(d).

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4. Surplus Line Companies and the IITA § 201(d-1) Rate Reduction

IITA § 201(d-1) provides for a rate reduction in foreign insurers whose state of domicile imposes a retaliatory tax. The rate reduction is determined on Illinois Schedule INS or UB/INS (see section at IITA § 201(D-1) RATE REDUCTION FOR FOREIGN INSURERS for more information). The rate reduction is not to reduce the sum of the foreign insurer's income and replacement taxes (plus privilege tax under Section 409 of the Insurance Code and other applicable assessments) below an amount equal to 1.75% "of the net taxable premiums written for the taxable year, as described by subsection (1) of Section 409 of the Illinois Insurance Code."

This provision is very specific about what premiums are taken into account, and has no provision similar to that in the definition of "direct premiums written" in IITA § 304(b)(1). IITA § 304(b)(1) refers to premiums reported on the annual statement or "such other form as may be prescribed in lieu thereof." A surplus line company has no premiums taxable under Section 409. This means that IITA § 201(d-1) can reduce a surplus line's income tax to zero.

IITA § 201(d-1) and IITA § 304(b) differ in their wording. IITA § 304(b) provides that surplus line premiums are included in the apportionment factor while IITA § 201(d-1) excludes them from the computation of the 1.75% premiums "floor" for the rate reduction. The instructions for the Schedules INS and UB/INS are consistent with statutory language. When calculating the tax reduction limit, the forms require the multiplication of 1.75% times "the net premiums taxable under Section 409 of the Illinois Insurance Code and included in your Form IL-1120 [sales everywhere]". Since surplus line premiums are includable in the apportionment factor but not taxable under the Illinois Insurance Code, if a foreign surplus line company has no other premiums but surplus line premiums, its 1.75% income tax reduction limit will be zero.

J. CAPTIVE INSURANCE COMPANIES

A captive is an insurance company created and wholly owned by one or more non-insurance companies to insure the risks of its owner (or owners). Captives are essentially a form of self-insurance whereby the insurer is owned wholly by the insured. They are typically established to meet the risk-management needs of the owners or members. Captives are formed to cover a wide range of risks; practically every risk underwritten by a commercial insurer can be provided by a captive. The type of entity forming a captive varies from a major multinational corporation—the vast majority of Fortune 500 companies have captive subsidiaries—to a nonprofit organization. Once established the captive operates like any commercial insurance company and are subject to state regulatory requirements including reporting, capital and reserve requirements. [REF: NAIC]

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The captive insurance company was originally designed to underwrite risks of a parent and/or its other subsidiaries. This initial form was considered a “pure captive.” The captive insurance industry has since grown to include more exotic arrangements. For example, many groups of unrelated persons have joined to form captive insurance companies to share in certain similar risks, such as medical malpractice for doctors and associations of industry groups.

A captive insurance company can underwrite domestic risks, foreign risks, or both. The coverage may include worker's compensation, property, liability, malpractice, etc.

A number of states have passed statutes specifically designed for captive insurance companies. The remaining states have no special provisions for captive insurance companies and they would have to meet the requirements of the individual state's insurance company laws and regulations. As of November 2012, U.S. states with captive legislation include Alabama, Arizona, Arkansas, Colorado, Delaware, Florida, Georgia, Hawaii, Illinois, Kansas, Kentucky, Maine, Montana, Missouri, Nevada, New Jersey, New York, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia and West Virginia. Many of these states have enacted legislation just within the last few years. Due to favorable regulatory conditions, a large number of domestic captive insurance companies are formed in Vermont. As of 2011, with close to 500 captives, Vermont, which began licensing captives in 1981, is the largest onshore captive, followed by Utah with roughly 189 captives, Hawaii (167), South Carolina (160), Kentucky (127), Nevada (117) and Delaware (86). (REF: Captive Insurance Times Issue 001, and NAIC, 2011)

Many corporations have also formed foreign captive insurance companies. Many tax-haven countries have favorable regulatory conditions for captive insurance companies. If incorporated in a foreign country, the captive insurance company will operate from that country even though it may underwrite U.S. risks. Also, in certain situations, particularly when foreign risks are being insured, certain tax advantages can accrue to shareholders of a foreign corporation. Due to favorable regulatory conditions, a large number of foreign captive insurance companies are formed in Bermuda.

A captive insurance company can be a direct writer or a reinsurance company. As a direct writer, it will issue policies and receive the premiums directly. There are few direct-writing captive insurance companies because of all the various onerous state regulations. Instead, most captive insurance companies operate as reinsurers. As a reinsurer, the captive insurance company assumes business from an admitted direct writing company, called the fronting company. In such an arrangement, the captive insurance company may retain the risk assumed from the fronting company or it may retrocede part of the risk to another company.

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The key purpose of insurance regulation is to protect policyholders first and foremost, as well as investors and other stakeholders. A captive is different from a commercial insurance company, because it just serves its parent company. Therefore, captives are regulated differently than traditional insurance companies that serve the public. Like traditional insurance companies, captives are regulated by the state in which its headquarters are located.

Each domiciliary regulator requires an annual audit by an independent CPA firm (or its equivalent) with industry-specific experience in the insurance industry. In addition, many domiciliary regulators require a formal actuarial review of the captive's policy on pricing and loss reserve methodology. [REF: NAIC]

1. General Types of Captives

There are a variety of captive types, depending on the owner's needs. While companies traditionally would set up "pure captives" to insure the parent and affiliates, companies over the years have set up more sophisticated captive arrangements to meet their business risk needs. The following list defines the most common structures:

- Single-Parent Captive – A company writing only the risks of its parent and/or affiliates. Single-parent structures are often referred to as wholly owned or "pure" captives.
- Group Captive –A captive established by a group of companies with similar businesses or exposures writing only the risks of its owners and/or affiliates.
- Association Captive – A captive owned by a trade, industry or service group (e.g., doctors) writing only the risk of its owners and/or affiliates. An association captive is similar to a group captive except that it is sponsored or owned by a group of entities within a particular organization with common insurance needs and similar exposures.
- Rent-a-Captive – A captive owned by an outside organization and open to participants for a fee. Members "rent" licenses and capital from the rent-a-captive owner. A rent-a-captive, or rental captive, is often used by entities that prefer not to form their own dedicated captive or for a program that is too small to justify incorporating its own captive.
- Risk Retention Group (RRG) – Approximately 250 RRGs in the U.S. are organized as captives. An RRG is an association or group captive formed for the principal purpose of assuming and spreading risk for commercial liability exposure. It is important to note that not all RRGs are licensed as captives. The formation of RRGs is authorized by a federal law—the Liability Risk Retention Act of 1986—that limits

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many of the regulatory requirements that otherwise might be imposed on RRGs by non-domiciliary states.

[REF: NAIC]

2. Reasons For Captives

The question is often asked why a corporation would go through the start-up costs and the capitalization expense to establish a captive insurance company. The answer depends upon the strategy of the parent corporation, which may include any of the following:

- The parent may wish to reduce the amount of money paid for insurance premiums. By establishing a captive, the parent has control over the amount of premiums paid as the captive will establish its own premium rates.
- The parent retains the profits made on insuring within its corporate structure instead of paying the premiums and the underlying profits to an unrelated third party.
- The parent may want to reduce the amount of risk retained in the affiliated group. By establishing a captive insurance company and acquiring its insurance through the captive, the parent can control the number of outside third-party insureds and thereby control the amount of risk involved with its insurance needs.
- Companies can mitigate their exposure to a wide range of risks. Practically every risk underwritten by a commercial insurer can be provided by a captive. The majority of captives provide mainstream property/casualty insurance coverage such as general liability, product liability, workers' compensation, director and officer (D&O) liability, auto liability and professional liability (e.g., medical malpractice).
- Captives can be used to obtain specialized coverage for unusual or hard-to-insure risks (e.g., terrorism risk). Oil companies have used captives to gird against environmental claims related to infrequent but potentially high-cost events. Other types of nontraditional insurance coverage that a captive could underwrite include credit risk, pollution liability, equipment maintenance warranty and employee benefit risks, including medical benefits, personal accident and, in some cases, whole life insurance.
- Establishment of a foreign captive can be used to funnel income to a country with no income tax, or a lower income tax rate than the tax rate in the United States. This offers a substantial savings on income tax expense.
- A domestic captive can be established to reduce the percentage of foreign

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insurance excise tax paid on premiums paid to foreign insurers or reinsurers.

REF: Foreign Insurance Excise Tax Audit Technique Guide (04/08), Internal Revenue Service and NAIC.

3. Qualifications Of A Captive Insurance Company

The issue encountered in audit is where the three-factor group (or other one-factor group) transfers substantial capital or intellectual property to an insurance company subsidiary (i.e. captive insurance company usually domiciled in Vermont) that only insures risk within the consolidated federal group. Although the captive is included in the consolidated federal Form 1120, since the captive insurance company apportions its income under IITA § 304(b), it cannot be included in a unitary group that apportions its income under another subsection of IITA § 304, following the noncombination rule as defined in IAC § 100.2430(b)(8). The unitary group then pays substantial insurance premiums, interest or royalties to the captive insurance company that reduces federal taxable income on the Illinois Schedule UB. Since few captives are in Illinois, they do not file an Illinois income tax return, thereby shielding the income from Illinois tax.

The following procedure has been developed when auditing a captive insurance company. The auditor needs to determine whether or not the captive insurance company meets the definition of an insurance company under rules used by the IRS. If so, then based on IITA § 102 the Department will abide by the federal determination because the term “insurance company” in the IITA follows the federal interpretation.

> Note. If the captive insurance company is owned by a bank or bank holding company as defined under IITA § 1501(a)(8)(A), then the captive insurance company will be treated as a financial organization and apportion its income under IITA § 304(c) and not IITA § 304(b), regardless of the federal determination.

4. Federal Treatment Of Captive Insurance Companies

The Federal taxation of a captive insurance company varies based on whether it is a domestic or foreign company. Regardless of its commercial domicile, the captive insurance company MUST qualify as an insurance company in order for the parent and/or its affiliates to get a deduction for insurance premiums paid to the captive insurance company.

As previously stated under Definition Of An Insurance Company, IAC § 100.3420(b) defines an insurance company as a company properly taxed for federal purposes under subchapter L of the IRC §§ 801 through 848. Therefore, we have to look to the IRC and

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Treasury regulation to determine if a company is an insurance company for Illinois purposes.

IRC §§ 831(c) and 816(a) define "insurance company" to mean "any company more than half the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies." (IRC § 816(a)) The definition provides only thresholds that must be surpassed in regard to the amount of insurance business that must be conducted in order for a company to be taxed as an insurance company. It does not define insurance contract. To be an insurance company for federal income tax purposes, a taxpayer must issue *insurance contracts*, and the issuing of insurance contracts must comprise *more than half* of the taxpayer's business. Courts and the IRS have stepped in to provide more detailed guidance. Both aspects of the definition are discussed below, beginning with its quantitative aspect.

Since *Helvering v. LeGierse* (1941), the federal courts and the IRS have taken up the issue of captive insurance companies and provided further explanation and guidance. Subsequent federal cases looking at captive insurance companies have considered three elements for determining if insurance exists regarding captives:

1. Insurance risk
2. Risk shifting and risk distribution
3. Insurance in the "commonly accepted sense"

See IRS PLR-133991-13 for a good, readable summary of the federal guidelines in determining insurance and captive insurance companies These three and some other elements that have come up over the years are discussed in the following sections.

Insurance risk: *Helvering v. LeGierse* (1941) mentions that an insurance contract must be actual insurance risk. In that case, the respondent received proceeds from as a beneficiary of a life insurance contract. The Court upheld that the life insurance contract and annuity contract executed by the decedent, when considered together, resembled investment risk, not insurance risk. The Court determined this even though the two contracts had the conventional elements of life and annuity contracts.

The insurance risk transferred must be risk of economic loss, not merely investment or business risk. This point and related sources are described in IRS PLR-133991-13:

The risk transferred must be a risk of economic loss. Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190, 1193 (7th Cir. 1978). The risk must contemplate the fortuitous occurrence of a stated contingency, Commissioner v. Treganowan, 183 F.2d 288, 290-291 (2d Cir. 1950), and must not be merely an investment or business risk.

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LeGierse, 312 U.S. at 542; Rev. Rul. 2007-47, 2007-2 C.B. 127; Rev. Rul. 89-96, 1989-2 C.B. 114.

Risk Shifting and Risk Distribution: *Helvering v. LeGierse* (1941) observed that insurance contracts must have the elements of risk-shifting and risk-distribution, and the federal courts and IRS have used this criteria over the years. The insured shifts its risk of loss to an insurance company, while the insurance company distributes that risk of loss among its many insurance contracts. For more discussion on this key element, see the Risk-Shifting and Risk-Distribution section later in this chapter.

Commonly Accepted Sense: The third element is whether the insurance contracts are insurance in the "commonly accepted sense". Several court cases have considered nonexclusive factors for determining if insurance qualifies under the "commonly accepted sense":

1. Its treatment under state law
2. The insurer's capitalization and charging arm's-length premiums
3. Separate funds to pay claims
4. The language of operative agreements and methods to resolve claims

IRS PLR-133991-13 describes the federal reasoning behind "commonly accepted sense":

The "commonly accepted sense" of insurance derives from all of the facts surrounding each case, with emphasis on comparing the implementation of the arrangement with that of known insurance. Court opinions identify several nonexclusive factors bearing on this, such as the treatment of an arrangement under the applicable state law, AMERICO, Inc., 96 T.C. 18, 41 (1991); the adequacy of the insurer's capitalization and utilization of premiums priced at arm's length, The Harper Group v. Commissioner, 96 T.C. 45, 60 (1991), aff'd 979 F.2d 1341 (9th Cir. 1992); separately maintained funds to pay claims, Ocean Drilling & Exploration Co. v. United States, 24 Cl. Ct. 714, 728 (1991), aff'd per curiam, 988 F.2d 1135 (Fed. Cir. 1993); and the language of the operative agreements and the method of resolving claims, Kidde Indus. Inc. v. Commissioner, 40 Fed. Cl. 42, 51-52 (1997).

5. More Than 50% Test

The federal definition of an insurance company was added to the IRC by the Tax Reform Act of 1984. (P.L. 98-369, 98 Stat. 494 (1984)). It states that an insurance company is:

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> Any company more than half the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. 26 U.S.C. § 816(a).

Therefore, in order to be an insurance company for federal income tax purposes, the issuing of insurance contracts must comprise more than half of the taxpayer's business.

The Committee Reports on P.L. 98-369 (Deficit Reduction Act of 1984) indicates that the *more than half* test is a facts and circumstances analysis:

> Whether more than half of the business activity is related to the issuing of insurance or annuity contracts will depend on the facts and circumstances and factors to be considered will include the relative distribution of the number of employees assigned to, the amount of space allocated to, and the net income derived from, the various business activities. It is the character of the business actually done in the taxable year which determines whether a company is taxable as an insurance company under the Code; see, e.g., *Service Life Insurance Co. v. United States,* 189 F. supp. 288, *aff'd on other grounds*, 293 F.2d 78 (8th Cir. 1961).

Note that investing premiums for the purpose of earning investment income is an integral part of the business of an insurance company. *See United States v. Atlas Insurance Co.*, 381 U.S. 233, 247 (1965); *Massachusetts Mutual Life Insurance Co. v. United States*, 5 Cls. Ct. 581, 590-591 (1984). However, excess amounts of investment income may indicate that a taxpayer's primary business is not insurance. In *Inter-American Life Insurance Co. v. Commissioner*, 56 T.C. 497 (1971), the Tax Court compared, among other factors, the amount of the taxpayer's premium income to its investment income in concluding that the taxpayer failed to qualify as an insurance company even though it was recognized as an insurance company under state law. The court found the amount of the taxpayer's premium income to be de minimis compared to its investment income. The court also found that the taxpayer did not maintain an active sales force, and that of the relatively few policies issued by the taxpayer, nearly all were issued to company insiders and their family members.

If the auditor feels that the taxpayer does not meet this test, then the auditor should forward a memo to Technical Support along with a worksheet showing why the 50% test has not been met, a description of the business activities of the captive insurance company, tax effect of the audit adjustment, etc. The auditor should also provide information on the relative amount of gross receipts from insurance contracts compared to total gross receipts, the proportion of the total contracts entered into by the company that qualify as insurance contracts, and the relative amount of investment income and

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insurance related activities. If Technical Support agrees with the auditor, the issue will be forwarded to Legal Services and management for possible audit adjustment.

6. Risk Shifting And Risk Distribution

As indicated above, in order for a company to be an insurance company it must engage in the business of issuing "insurance" contracts. This has been the major issue at the federal level in the captive context. In other words, are the contracts between the members of an affiliated group and the group's insurance subsidiary truly "insurance" contracts.

The U.S. Supreme Court defined insurance in the 1941 case *Helvering v. Le Gierse*, 312 U.S. 531 (1941). The Court said that in order to be "insurance" an arrangement must consist of both "risk shifting" and "risk distribution." Risk shifting involves the shift of the financial risk of a potential loss from an insured to a financially capable insurer in exchange for payment of a premium that is less than the risk insured. With risk shifting the focus is on the insured, and whether through the arrangement with the insurer it has insulated itself from the risk of loss. Risk distribution, on the other hand, focuses on the insurer. Risk distribution is the mechanism through which the insurer spreads its risks over a sufficiently large pool of insured parties. The court observed that risk distribution exists when the following factors are present: (i) the insurer has a sufficient number of exposures for the statistical law of averages to function, (ii) the exposures present approximately the same chance of loss, and (iii) the exposures are each separate and distinct. For risk distribution, no one insured can account for more than 15% of the total risk of loss transferred or more than 15% of the total premiums paid to the captive.

7. Economic Family Doctrine

The Department can no longer apply the "economic family doctrine" that was discussed in IRS Revenue Ruling 2001-31. That position was based on the idea that where the ultimate burden of economic loss is retained within the same economic family (i.e. the affiliated group) that suffered the loss, there can be no insurance because risk of loss has been neither shifted nor distributed. However, no court ever adopted the economic family doctrine and the IRS announced in Revenue Ruling 2001-31 that it would no longer challenge captive insurance arrangements under that doctrine.

8. Balance Sheet Test

One of the tests that courts and the IRS use to evaluate whether or not an arrangement with a captive involves risk shifting by applying the so-called "balance sheet test." In practice, application of this test generally results only in contracts between the affiliated

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group's parent and the captive insurance subsidiary **not** qualifying as "insurance" contracts. See *Humana Group v. Commissioner*, 979 F.2d 1341 (9th Cir. 1992). The rationale is that the parent cannot shift the financial risk of loss to the captive subsidiary because any claims paid by the captive cause a decline in the captive's net assets, which decline is reflected by a corresponding decline in the value of the captive's outstanding stock. Since the parent owns the captive's stock, it suffers that decline in value, and hence the economic detriment of claims paid by the captive. Because the contracts between the parent and captive are not insurance contracts, purported premiums paid by the parent to the captive are not deductible by the parent for federal purposes. The balance sheet test does not, however, result in contracts between the brother-sister subsidiaries and the captive from being considered insurance contracts. Because the brother-sister subsidiaries do not own stock in the captive, losses paid by the captive have no effect on the separate balance sheets of the brother-sister subsidiaries. Assuming then that the captive's contracts with the brother-sister subsidiaries are more than half of the captive's business, and that overall arrangement satisfies commonly accepted notions of insurance (discussed below), then the IRS considers the captive insurance company a true insurance company even though the contract with its parent may not be an insurance contract. In a unitary group, if the captive is a true insurance company by virtue of its contracts with brother-sister subsidiaries, then the captive is excluded from the group under the noncombination rule.

The IRS Audit Techniques Guide lists the following cases as support for its position:

- *Harper Group v. Commissioner*, 979 F.2d 1341 (9th Cir. 1992)
- *Humana, Inc. v. Commissioner*, 881 F.2d 247 (6th Cir. 1989)

The IRS agent would develop the issue based on these cases.

Commonly Accepted Notions of Insurance

In *Kidde Industries, Inc. v. United States*, 40 Fed. Cl. 42 (Fed. Cl. Ct. 1997), the court stated that, in addition to risk shifting and risk distribution, a captive arrangement must be consistent with commonly accepted notions of insurance. In general, this means that the parties must deal with each other in substantially the same way as unrelated parties would deal with each other. Factors relevant to this analysis include the following:

- Written insurance policies that specify covered risks and claims presentation executed prior to the beginning of coverage;
- Arm's-length premiums determined in a manner consistent with industry practice;
- Timely payment of required premiums;

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- The captive insurance company is adequately capitalized;
- The captive has a professional insurance staff;
- The captive has not made loans to the parent or other subsidiaries.

Captive Insurance Company with Third-Party Premiums

If the captive insurance subsidiary accepts a significant portion of its premium income from unrelated third parties, the IRS considers that risk has been shifted and distributed outside the affiliated group. True insurance exists for income tax purposes and the insurance expense for the premiums paid would be an allowable federal deduction. The IRS uses a 30% threshold figure to determine if the third-party premiums are significant. For more information the IRS audit techniques service guide refers to the following:

- *Sears Roebuck and Co. v. Commissioner*, 972 F. 2d 858 (7th Cir. 1992)
- *AMERCO v. Commissioner*, 979 F.2d 162 (9th Cir. 1992)
- *Ocean Drilling & Exploration Co. v. United States*, 988 F.2d 1135 (Fed. Cir. 1993)
- *Harper Group v. Commissioner*, 979 F.2d 1341 (9th Cir. 1992)

a) Business Purpose / Sham Transaction

In general, the Department will not treat any captive insurance company as a sham transaction. The IRS rules on sham transactions are too difficult to apply in a normal audit situation. However, courts have come to find the existence of either of two particular facts to cause a captive arrangement to automatically be considered a sham. These two facts, (i) undercapitalization of the captive, or (ii) any sort of indemnity, hold harmless, or capitalization agreement by the parent that serves to guarantee the captive's performance. For example, in *Malone & Hyde, Inc. v. Commissioner*, 62 F.3d 835 (6th Cir. 1997) the parent of an affiliated group obtained coverage from an unrelated third-party insurer to insure risks of itself and subsidiary corporations, which the third-party insurer then reinsured with the parent's wholly-owned captive. The captive was formed in Bermuda and met that country's capital requirements, but those requirements were more relaxed than those found in U.S. jurisdictions. In addition, the parent corporation had entered into hold-harmless agreements with the third-party insurer in which the parent guaranteed the captive's performance under the reinsurance agreement. The taxpayer argued that although undercapitalization and the hold-harmless agreements would result in the parent not having shifted risk to the captive, they would have no bearing on whether the subsidiary corporations shifted risk. Under the balance sheet test, the subsidiary corporations shift risk whether or not the parent must perform under the guarantee. The court nonetheless rejected the entire captive arrangement, including the policies

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covering the affiliates, finding that undercapitalization plus the hold-harmless agreements demonstrated the arrangement to be a sham.

9. Illinois Treatment

In auditing a captive insurance company, the major issue faced by the auditor is whether the company should be treated as an insurance company and its income apportioned under IITA § 304(b) or as a regular three-factor company and its income apportioned under IITA § 304(a).

When auditing a captive insurance company, the auditor must determine whether or not the captive insurance company was accepted as an insurance company by the IRS. Those procedures are stated above.

If the IRS did not specifically audit the captive insurance company, the Department will conduct an independent analysis of the captive.

If the captive insurance company is NOT treated as an insurance company on the parent's federal income tax return, it should not be treated as an insurance company required to apportion its income under IITA § 304(b).

If the captive insurance company was treated as an insurance company under Subchapter L of the IRC, the parent's federal return should reflect that:

- ALL of the premiums paid by the parent and/or its subsidiaries to the captive insurance company should be claimed as a deduction on the parent's federal income tax return; and

- The captive insurance company should have claimed a deduction for reserves for unpaid losses, including a reserve for incurred but not reported claims (a reserve deduction).

Note: It may be difficult to tell if the captive insurance company has loss reserves because it will not be apparent from reviewing the federal return or financial statements. The auditor probably will have to review the workpapers that make up the federal return, probably for other income or other expenses.

If the captive was treated as an insurance company on the parent’s federal return, the next step is to determine if that was PROPER treatment. The proper treatment for a captive insurance company must be determined on the basis of the federal regulations

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and Revenue Rulings. Two situations must be considered: if the IRS conducted an audit on the federal return, or if the IRS did not conduct an audit on the federal return.

If the IRS has conducted an audit of a federal consolidated group which includes a captive insurance company, even if the captive treatment is allowed, the auditor must determine if the issue was specifically addressed in the federal audit. If the IRS has examined the captive treatment, and has determined that the captive qualifies as an insurance company, it should be treated as an insurance company for Illinois.

However, if the IRS did a limited scope audit which did not address the issue, or if the IRS determined that the captive issue was immaterial for federal purposes, the Illinois auditor must examine this issue and determine the proper treatment in accordance with the IRS Regulations and Revenue Rulings. If the captive is properly treated as an insurance company, it should be treated the same for Illinois purposes.

If the insurance company treatment is proper, the captive should be treated as an insurance company under IITA § 304(b).

10. Premiums Numerator – Captive Insurance

If a captive insurance company insures risk in Illinois, then there is a presumption that there is Illinois nexus unless the taxpayer proves otherwise. There must be sufficient activities conducted by the captive insurance company to assert nexus. See the discussion earlier in this Chapter at "Nexus".

A captive insurance company might not file reports with the Director of Insurance, so there may be no Schedule T showing direct premiums written in Illinois. In that case the auditor will have to rely on IAC § 100.3420(d) where it states in part:

> …If an insurance company does not file an annual statement with the Director of Insurance or if any direct premiums written by an insurance company are not allocated to a specific state on its annual statement, that insurance company shall include in the numerator of its apportionment factor the direct premiums written for insurance on property or risk in this State, determined in accordance with the determination of gross taxable premiums written under Section 409(1) of the Illinois Insurance Code [215 ILCS 5/409(1)]...

If the taxpayer will not provide the auditor with records to support an Illinois numerator under Section 409(a) of the Illinois Insurance Code, then the auditor will have to estimate an Illinois factor based on best available records. The auditor could get the Illinois payroll from IL-941s filed by the subsidiaries doing business with the captive, or

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the auditor could get a listing of Illinois property or even schedule out Illinois sales from sales tax returns in order to estimate an Illinois premiums factor.

In determining whether a company is a true captive insurance company and if it has Illinois nexus, two useful questionnaires developed in the field are shown in the Exhibits Section under Questionnaires. Both contain questions that may help the auditor develop a nexus and/or captive insurance position. While both questionnaires contain a mixture of questions that address both nexus and insurance, the first tends more towards a captive insurance determination, while the second more towards nexus.

11. Identifying a Captive

There may be situations where it is not obvious that a federal consolidated group has a captive insurance company as a member. For example, the parent could be a noninsurance company 1120 filer and the captive an 1120-PC filer. The following items are some basic things to consider in order to identify the captive insurance company in the federal consolidated group:

- Look and see if any companies have “insurance” or “reinsurance” in their names on Form 851 or a list of the subsidiaries (like Form 7004 Application for Extension).
- See if box “1b Life/nonlife consolidated return” is marked on the face of the consolidated federal Form 1120. If so, there is a captive life and maybe nonlife company in the consolidated group.
- Review Form 851 – Affiliations Schedule, Part II, It will list the Principal Business Activity with a number. A captive should have one of the codes for carrying lines of insurance (not related insurance activities or broker). For example, it might say “Insurance carrier” for activity, and the code could be “524150 - Direct Insurance & Reinsurance (except Life, Health, & Medical) Carriers”. The codes are in the Form 1120 instructions.
- You should likely see an 1120-PC or 1120-L return included showing the separate insurance company or subgroup information.
- More importantly, the alleged captive should be reporting income from insurance premiums and reporting losses from paying insurance claims. The “premiums written” will be buried in Line 10 “Other income” of the parent’s consolidated Form 1120.
    - You should be able to find that in a statement showing the separate company breakdown for Line 10, which should report something like “premiums written” for the captive.
- The losses should be buried in the parent’s Line 26 “Other deductions”.

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  - You should be able to find that in a statement showing the separate company breakdown for Line 26, reporting something like "Losses paid during the year".
- You will need an Annual Statement from the alleged captive that they file at least in their state of domicile.
- Review the parent's Form 10-K annual report.
- Simply ask the taxpayer if you are not sure.
  - The EDA-132-NI for nexus also has questions regarding if the taxpayer has captives, so this could be used to help identify captives as well.

12. *Wendy's* (2013)

An important and controlling Illinois case regarding the determination of captive insurance companies is *Wendy's International, Inc. v. The Department of Revenue*, 375 IllDec 194 (Ill. App. 4th, 2013). The taxpayer ("Wendy's") is an international fast food restaurant chain, headquartered in Ohio. The Department audited Wendy's and issued two NODs for consecutive audit cycles, challenging and including a company in Wendy's UBG that Wendy's had not included and treated as a captive insurance company.

Wendy's set up Scioto Insurance Company ("Scioto") in Vermont in 2001 to insure its affiliated entities. Scioto acquired Oldemark LLC ("Oldemark") in order to be sufficiently capitalized. Oldemark held Wendy's trademarks, earned a substantial amount of royalties and filed as a disregarded entity. Thus, Scioto's royalty income from Oldemark far surpassed its insurance premiums income: in some years Scioto's royalty income was more than ten times greater than its insurance premiums income. The Department asserted that Scioto should not be treated as an insurance company, for some of the following reasons:

- There was no actual risk shifting or risk distribution
- The majority of Scioto's income was from intercompany royalties, not insurance premiums, so the majority of its business was not from insurance
- Scioto was not regulated in all states where it insured risk

The Department issued NODs for the 2001-2003 and 2004-2006 cycles. Wendy's protested, countering that they were a bona fide insurance company, qualified as an insurance company under the IRC, shifted and distributed risk, and was protected under the Illinois Constitution's uniformity clause (Illinois cannot discriminate against a non-Illinois insurance company). The trial court upheld the Department's NODs and Wendy's appealed.

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The Illinois Appellate Court reversed and found in favor of Wendy's, determining that Scioto should be treated as an insurance company. One important take-away from the case was that the Court's explanation "more than half of the business" analysis is not a mere insurance premiums gross receipts test, as stated in this excerpt:

While Scioto's income from insurance premiums was dwarfed by its royalty and interest income, "it is not any percentage of income that determines whether a company is taxable as an insurance company but rather the character of the business actually done by the company." *Service Life Insurance Co. v. United States*, 189 F. Supp. 282, 285-86 (D. Neb. 1960).

The Court determined Oldemark was in business for licensing intangibles, and Scioto was in business for insuring Wendy's and affiliates. Scioto's ownership of Oldemark was necessary so it could be capitalized sufficiently under Vermont law. The Court also found the following that Scioto did demonstrate risk-shifting and risk-distribution, and that the IRS and Vermont treated Scioto as an insurance company. Therefore, Scioto qualified as an insurance company and Illinois should treat it as such.

Auditors must consider this case and its reasoning when making a similar captive insurance determination. The percentage of income received from insurance premiums is an important criteria and evidence to consider. However, *Wendy's* (2013) shows that percentage may not be determinative. We would expect an insurance company to have most of its income from insurance premiums, but there could be exceptions like Scioto. A full analysis of the facts is necessary to see if it meets the elements of an insurance company. See further discussion of the elements of an insurance company in Section "J. CAPTIVE INSURANCE COMPANIES".

K. HEALTH MAINTENANCE ORGANIZATIONS

Any Health Maintenance Organization (HMO) that is properly treated as an insurance company under the IRC should also be treated as an insurance company under the IITA and required to apportion its income under IITA § 304(b). If an HMO is NOT properly treated as an insurance company for federal income tax purposes, it SHOULD BE treated as a three-factor company and its income apportioned using IITA § 304(a).

The following types of HMOs should be treated as follows:

- A staff model HMO does not qualify as an insurance company for federal income tax purposes (see IRS Revenue Ruling 68-27 for more information).

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- An individual practice association (IPA) does qualify as an insurance company for federal income tax purposes (see IRS Private Letter Ruling 9412002 for more information).
- A network-model HMO does qualify as an insurance company for federal income tax purposes (see IRS TAM 201117027 for more information).

L. RISK RETENTION GROUPS

A Risk Retention Group (RRG) is formed pursuant to the provisions of the Federal Liability Risk Retention Act of 1986. Under the IITA, a RRG is considered to be an insurance company, is required to file an IL-1120 return, and is required to use IITA § 304(b) to apportion its income. REF: IT 91-0035.

All RRGs, regardless of place of incorporation or domicile, which collect premiums from insureds in Illinois are required to pay a privilege (premium) tax to the Illinois Department of Insurance. REF: Illinois Insurance Code § 409.

M. POOLING OF RISKS

When risks are substantial or unusual, a company may not be able to obtain insurance through a regular insurance company. Pooling arrangements may be used to secure insurance in these situations. “Pooling” is defined as an organization of insurers or reinsurers through which particular types of risks are underwritten with premiums, losses, expenses, and profits shared in agreed ratios. This is also known as an “association” or “syndicate”. An example of pooling would be a group of six unrelated roofing companies within a geographical area coming together to form an insurance company. Domestic companies may form an offshore insurance company for tax avoidance purposes. Another likely possibility would be a group of Illinois nexus companies forming an insurance company incorporated and headquartered in a state like Vermont or Hawaii.

1. Reasons For Pooling Arrangements

There are two reasons why companies may form pooling arrangements:

1. The type of industry pooled does not lend itself to outside insurance, and/or
2. A refusal of insurance companies to accept certain risks.

Pooling arrangements are established along an industry line such as in construction, the legal profession, or petroleum. Each industry has its own specific risks. For example, petroleum companies are exposed to risks of damage from pollution, wild oil or gas well fires, and the transportation of fuel oil, to name a few. Because of the type and

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probability of risks, traditional insurance companies may not insure or require prohibitively expensive insurance premiums. Through the pooling arrangements, a group of companies can insure risks and/or lower premiums can be secured.

2. Pooling Characteristics

For the pooling arrangement to be treated as true insurance, the following characteristics generally must be present:

- The pooling arrangement is comprised of economically unrelated shareholders *and* their subsidiaries and/or affiliates.
- None of the shareholders own a controlling interest.
- The risk of loss for each shareholder must be shared with all shareholders.
- The insurance company provides insurance coverage only to the shareholders and their affiliates. No outside third-party coverage is provided.
- Premium rates are established according to customary industry rating formulas. The insurance company may take into account the unique risks of the insureds in establishing its rates.
- There must be a shifting of risk and distribution of the risk of loss.

Example #35

A pooling arrangement is established in Vermont to insure the risks of six unrelated bridge construction companies against the damages incurred should a bridge fail due to faulty construction. Each of the six owns an equal amount of the insurance company, and has provided an equal amount of capitalization.

Premiums for casualty insurance are determined according to regular insurance standards with adjustment for the type of bridges being constructed and other industry risks specific to each company. The insurance company does not accept risks outside of the six construction companies.

As long as the risk of loss is shifted and distributed, the IRS would respect the arrangement as true insurance, which would make it qualify as insurance for Illinois purposes.

3. Risk-Shift And Risk-Distribution

Like with captive insurance companies, there must be evidence of risk-shift and risk-distribution for a pooling arrangement to be considered insurance. If the pool members do not commingle the premium funds and share in the losses, there is no risk-shift and

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no risk-distribution. Essentially, each member would be self-insuring through their own capital accounts. This was presented in the federal case *Helvering v. LeGierse,* 312 U.S. 531 (1941) and Rev. Ruling 60-275. Members of a pool must be able to demonstrate the premiums are paid to and commingled in the pool's account, and that losses are paid out of the pool's account, which should be evidenced by the financial statements of the pool. If members are not paying into a commingled account and separately pay losses out of their own capital account, no true insurance is taking place.

Pooling arrangements for insurance are a form of captive insurance. Although there is more than one insured and the insureds are not related according to stock ownership, the pool will not accept risks outside the type of industry risks being insured. Thus, it is only the risks of the pooling insureds which are accepted. The number of pool members can vary from as few as two to an unlimited number depending upon the type of industry and the number of insureds interested.

As long as none of the shareholders owns a controlling interest in the entity and the premium funds are commingled, there is a pool. If one entity owns a controlling interest, there is no pool. Instead, there is a partnership or a parent-subsidiary relationship with outside ownership interests.

REF: Excise Tax-Foreign Insurance, IRS Audit Technique Guide.

N. HOLDING COMPANIES

1. IITA § 1501(a)(27)

For taxable years ending on or after December 31, 1987, holding companies (other than a bank holding company), can be included in the same unitary group with companies apportioning under different subsections of IITA § 304, that is, under (b) insurance companies, (c) financial organizations (c-1) federally regulated exchanges, and (d) transportation services. Further, a holding company for these periods can be split among more than one unitary business group.

This came about because of P.A 85-731 and P.A. 97-057. P.A. 85-731 permitted a transportation or insurance holding company to file as a member of the respective transportation or insurance UBG. P.A. 97-057 extended the non-combination exception of holding companies to apply to financial organizations and federally regulated exchanges. It also allowed holding companies to be split among different UBGs. Finally, it provides that the holding company's business income must be apportioned using the apportionment formula used by the group with which it is combined; e.g., if the holding company is combined with a group of insurance companies, the business

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income of the group (including the holding company) is apportioned under IITA Section304(b)). IITA § 1501(a)(27)(C)(iii) provides the following:

> A holding company shall apportion its business income under the subsection of Section 304 used by the other members of its unitary business group. The apportionment factors of a holding company which would be a member of more than one unitary business group shall be included with the apportionment factors of each unitary business group of which it is a member on a pro rata basis using the same method used in clause (ii).

This provision has two parts. The first sentence explains how the holding company will apportion its income with the UBG it joins. The second sentence explains how to split the factors in case the holding company must be included in more than one UBG.

Certain taxpayers have tried to argue that the holding company only has to use the joined UBG apportionment method if there is only one UBG, and is evidenced by the reference of plural UBGs in the second sentence, but not in the first sentence, of IITA § 1501(a)(27)(C)(iii). These taxpayers are incorrect.

The language clearly says that a holding company must apportion using the method of the UBG it joins. This must be applied whether there is only one UBG, or a split among several UBGs. The second sentence must be stated in the plural because the factors will only be split if there are several UBGs. The first rule of statutory construction is that where the language of a statute is clear, a court must apply its plain meaning as written (*Connecticut National Bank v. Germain*, 503 U.S. 249, 254 (1992)). "Where the words of a statute are unambiguous, this first cannon is also the last: 'judicial inquiry is complete.' " (quoting *Rubin v. United States*, 449 U.S. 424 (1981)). Following the aforementioned cardinal rule, we look to the terms used in IITA § 1501(a)(27)(C)(iii), applying to these terms their plain and ordinary meaning. The express, ordinary language of this statute tells us what to do, and no additional speculation is required.

Now, admittedly this leads to the situation where the factors for the holding company that joins the insurance group will equal zero, and thus not impact the insurance UBG. This is because the holding company's factor will be based upon IITA § 304(b) and its insurance premiums. Assuming the holding company has no insurance premiums, all its other receipts are irrelevant and do not affect the insurance group to which its income will be allocated. In other words, the holding company's income that is included in the insurance UBG will be sourced to Illinois based upon the insurance UBG's apportionment factor without taking into account the holding company's receipts. This is the consequence of applying Illinois statutes, not opinions about the consequences.

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For years ending prior to December 31, 1987, a holding company can only be included in a unitary group with other companies required to apportion their income under IITA § 304(a) (i.e. three-factor companies).

Example #36

For the year ending December 31, 1986, holding company HC is engaged in a unitary business with insurance companies A and B. HC would be required to file a separate return and apportion its income under IITA § 304(a). A and B would be required to file on a unitary basis and would be required to apportion their income under IITA § 304(b).

Example #37

For the year ending December 31, 1987, holding company HC is engaged in a unitary business with insurance companies A and B. HC, A, and B would be required to file on a unitary basis.

Example #38

For the year ending December 31, 1996, holding company HC is engaged in a unitary business with company A which is an insurance company, company B which is an insurance agency (the company sells insurance but does not write any insurance policies and does not qualify as an insurance company), and company C which performs some service activities for the insurance agency and the insurance company. In this case, neither B nor C can be combined with the insurance company because they are required to apportion their income under IITA § 304(a). The income (loss) and the factors for HC would be split between two unitary groups: (1) the insurance group which would consist of A and a portion of HC; and (2) the three-factor group which would consist of B, C, and a portion of HC.

Example #39

For taxable year ending December 31, 2013, Holding Company (HC) is engaged in a unitary business with a group of companies, some which are insurance companies (IC) and must apportion under IITA § 304(b), and some which provide financial services (FS) and must apportion under IITA § 304(a). HC will generally be required to be split between the two UBGs, IC and FS. The business income of HC that is included in the combined return with IC will be apportioned under IITA § 304(b) and the business income of HC included in the combined return with FS will be apportioned under IITA § 304(a).

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Example #40

For taxable year ending December 31, 2010, Holding Company (HC) is engaged in a unitary business with a group of transportation companies (TC) and a captive insurance company (CI). HC did not split its income originally between TC and CI, nor did it request alternative apportionment following IAC § 100.3390. Under audit, the auditor should properly split pro rata, or under any reasonable method, HC's income and apportionment factors between TC and CI. The business income of HC that is included in the combined return with IC will be apportioned under IITA § 304(b) and the business income of HC included in the combined return with TC will be apportioned under IITA § 304(d).

See Audit Manual Chapter 29 on Holding Companies for more information.

O. GENERAL FEDERAL LINES OF INTEREST: 1120-PC, 1120-L

Lines of Interest, federal Form 1120-PC

The layout of a federal Form 1120-PC differs from a federal Form 1120. The following bullet points indicate a few lines of interest for the Illinois audit. These are taken from a blank 2017 Form 1120-PC, so the lines may differ depending on the filing year. This is not an exhaustive list.

- Box A, p.1: Indicates whether the 1120-PC is consolidated (Box 1) and if the group includes both life insurance and nonlife insurance companies (Box 2). Under certain conditions, a consolidated group could include life insurance companies, nonlife insurance companies, and 1120 filers (noninsurance companies). The type of parent controls the type of consolidated return filed. For example, in a mixed group of insurance and noninsurance companies, if the parent is a noninsurance company, the insurance companies will subconsolidate within the consolidated federal Form 1120. For more information, see the federal Form 1120/1120-PC/1120-L instructions and federal consolidated regulations for IRC § 1502 (for example, CFR § 1.1502-47(s) for life/nonlife consolidation rules.
- Line 1 Taxable income (Schedule A, line 37), p.1: An 1120-PC determines its taxable income on Schedule A, and then carries that over to Line 1, p.1. This amount is the starting point for the Illinois return.
- Schedule A: This is basically the income statement of the 1120-PC, similar to p. 1 of an 1120.
    - Schedule A, Line 1: Premiums earned, which can be compared to what is reported on Annual Statement.

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  - Schedule A, Line 3b: Tax-exempt interest (must subtract amortization of premium)
  - Schedule A, Line 37: Taxable income, carried to p. 1
- Schedule C: Here is the dividend information, similar to an 1120's Schedule C, used to complete Illinois Schedule J.
- Schedule E, Line 1: Shows net premiums written, which can be compared to what is reported on Annual Statement.
- Schedule F, Line 9: Another place to find tax-exempt interest.
- Schedule I, Line 10: Yet another place to find tax-exempt interest.

Lines of Interest, federal Form 1120-L

The layout of a federal Form 1120-L differs from both the federal Form 1120-PC and the federal Form 1120. The following bullet points indicate some lines of interest. These are taken from a blank 2017 Form 1120-L, so the lines may differ depending on the filing year. This is not an exhaustive list.

- Box A, p.1: Indicates whether the 1120-L is consolidated (Box 1) and if the group includes both life insurance and nonlife insurance companies (Box 2). Under certain conditions, a consolidated group could include life insurance companies, nonlife insurance companies, and 1120 filers (noninsurance companies). The type of parent controls the type of consolidated return filed. For example, in a mixed group of insurance and noninsurance companies, if the parent is a noninsurance company, the insurance companies will subconsolidate within the consolidated federal Form 1120. For more information, see the federal Form 1120/1120-PC/1120-L instructions and federal consolidated regulations for IRC § 1502 (for example, CFR § 1.1502-47(s) for life/nonlife consolidation rules.
- Line 1, p.1: An 1120-L determines its taxable income on p.1 of the return, unlike the 1120-PC. Line 1 reports gross premiums, which should be comparable to what is reported on the Annual Statement.
- Line 27, p.1: Taxable income. This amount is the starting point for the Illinois return.
- Schedule A: Here is the dividend information, similar to an 1120 and 1120-PC's Schedule C, used to complete Illinois Schedule J.
- Schedule F:
  - Here is information for the IITA Sec. 203(b)(2)(I) subtraction modification (Lines 1-8).
  - Tax-exempt interest is on Line 13.
- Schedule G: Gross and net premiums are listed on Lines 1 and 3. These should be comparable to what is reported on the Annual Statement.

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P. INSURANCE COMPANY GLOSSARY

The following glossary has been included to assist you in understanding the language of the insurance business. It is not all-inclusive, but can be a starting point in developing knowledge of the insurance industry.

Admitted Assets
In general, the admitted assets of an insurance company include the following types or classes of assets: cash, stocks, bonds, collateral loans, mortgage loans, loans to policyholders, interest, dividends and real estate income due and accrued, real estate owned, and premiums due. The state departments of insurance permit only admitted assets to be used in determining the total assets available against the companies' liabilities. However, for federal tax purposes, the term "assets" includes non-admitted assets.

Alien Company
A company incorporated or organized under the laws of any country other than the United States (215 ILCS 5/2(h)).

Annual Statement
Insurance companies are regulated by state insurance commissions and are required to file, annually, detailed financial statements (Annual Statements) with those regulatory bodies. These Annual Statements are verified and audited by Insurance Commission examiners. The National Association of Insurance Commissioners has prescribed a standardized financial report that is called the Annual Statement or Convention Form. The National Association of Insurance Commissioners has prescribed a separate Annual Statement for life insurance companies and property and casualty companies.

An Annual Statement contains the following information:

- Balance Sheet;
- Summary of Operations;
- Analysis of Operations;
- Analysis of increases in reserves;
- Exhibits supporting items on the balance sheet and the summary of operations;
- General Interrogatories;

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- Various supporting schedules detailing items on the balance sheet and the summary of operations;

- Schedule T showing state apportionment of the premiums.

Annuity
A contract sold by insurance companies that pays a monthly (or quarterly, semiannual, or annual) income benefit for the life of a person (the annuitant), for the lives of two or more persons, or for a specified period of time.

Assumption Reinsurance
Reinsurance of the entire business, part of the business, or block of policies under an arrangement whereby the purchasing company becomes solely liable to the policyholders on the contracts transferred.

Authorized Company
A company authorized by the State Department of Insurance to do business in its state.

Convention Form or Blank
The Annual Statement established by the National Association of Insurance Commissioners for reporting in detail the condition and activities of an insurance company.

Domestic Company
A company incorporated or organized under the laws of this state (215 ILCS 5/2(f)).

Deferred Premium
The portion of the annual premium unpaid at any year end. Installment premiums payable monthly, quarterly or semi-annually which have not fallen due are included.

Direct Premiums
All premiums (less return premiums) arising from policies issued to afford primary (issuing company) insurance for a given hazard.

Dividends to Policyholders
Refunds or rebates of premiums to policyholders as distinguished from dividend distributions to shareholders.

Earned Premium
When a premium is paid in advance for a certain time, the company is said to "earn" the premium as the time advances. For example, a policy written for three years and paid in advance would be one-third "earned" at the end of the first year of the policy term.

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Finder's Fee
Fees paid to an individual for finding or establishing the contract that makes a financial transaction possible. Fees paid to correspondents of an insurance company for securing mortgage loans, etc. A large borrower may also pay a finder's fee to an individual that knows of an insurance company that is willing, able and does lend funds to the borrower.

Foreign Company
A company incorporated or organized under the laws of any state of the United States other than this state (215 ILCS 5/2(g)).

Fraternal Benefit Societies
Any incorporated society, order or supreme lodge without capital stock, including one exempted under the provisions of Section 315.5(a) of Chapter 73 of the Illinois Revised Statutes whether incorporated or not, organized solely for the benefit of its members and their beneficiaries and not for profit, operated on a lodge system with ritualistic form of work, having a representative form of government and providing benefits in accordance with Chapter 73 of the Illinois Revised Statutes is hereby declared to be a fraternal benefit society.

Gross Line
The amount of insurance the company has on risk including the amount it has reinsured.

Group Insurance
A plan where a number of persons are insured under a single policy.

Home Office
The principal place of business of the company: the head office.

Incurred
The insurance industry uses the terms "incurred losses" and "incurred expenses." A loss or expenditure is incurred when it happens although it may not be reported or paid until later.

Internal Revenue Code § 847
Under the IRC, an insurance company is allowed a deduction for reserves accrued for covered losses which have been incurred by its policyholders, but which had not yet been paid. These deductible reserves may include estimates for losses that have been incurred, but not reported by the policyholder, as of the end of the year, as well as amounts that are in dispute. Taxpayers other than insurance companies are not allowed to deduct such items.

Prior to the Tax Reform Act of 1986, an insurance company could accrue the total amount of its estimated losses, even in cases where it was certain that the losses would not be paid

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until several years after the time of the deduction. In the Tax Reform Act of 1986, IRC § 832(b)(5) was amended to allow deduction only for the present value of unpaid losses, discounted for the time value of money pursuant to the new IRC § 846.

There was a substantial uproar about the so-called "fresh start" transition rules for implementing the new law. The transition rules, in many cases, converted a timing matter into a permanent deduction. However, some insurance companies could not take advantage of the transition rules because the IRS had already been asserting on audit that insurance companies should discount their losses, and some insurance companies had agreed to the audit adjustments. Other insurance companies were already discounting their losses voluntarily.

One of the results of the problems with the implementation of the transition rules was the enactment of IRC § 847 in the Technical and Miscellaneous Revenue Act of 1988. IRC § 847 permits an insurance company that is required to discount the amount of unpaid losses, in computing its losses incurred deduction to take an additional special deduction to account for that discounting. This deduction is allowable, to the extent that the company establishes and maintains a special loss discount account, and makes special estimated tax payments with respect to the tax benefits the insurance company receives.

The amount of the additional deduction is limited to the excess of the company's undiscounted unpaid losses over its related discounted unpaid losses for the tax year. The excess is deducted to the extent that the insurance company did not deduct this excess in an earlier tax year.

Generally, the special deduction is allowed only to the extent that the insurance company makes special estimated tax payments on or before the date that its taxes are due for the year of the deduction. The amount of the special estimated tax payments that are made in a tax year must equal the amount of the tax benefits attributable to the additional deduction for that year. The amount of the tax benefit is determined under IRS regulations. The tax savings are computed without regard to IRC § 1503(c) limitations.

Investment Income
This is the income earned by placing the cash from Premium Income in income-producing assets.

Ledger Assets
Book value of investments, bank deposits, and other tangible items, as well as certain intangible items such as balances, uncollected premiums or recoverable paid losses. Such assets are recorded on the company's general ledger.

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Mutual Company
A company without stockholders or capital stock. All risks and all profits are the property of the policyholders.

Net Premiums
In casualty insurance, net premiums are gross premiums less reinsurance ceded. In life insurance, net premiums are the portion of the premiums calculated on the basis of a particular mortality table and interest rate; to enable the insurer to pay benefits as provided by the insurance contracts, no account being taken of expenses, contingencies, or profit.

Non-Admitted Asset
Asset of an insurance company which by statute the company is not permitted to include in its financial statements. Such assets include office furniture and equipment and accounts over 90 days past due.

Non-Ledger Assets
Assets resulting from investments through excess of market (or amortized) value over book values, and interest and other income due or accrued on such investments. Such assets are not recorded on the company's general ledger, but are available from supplementary ledger records or other sources.

Policy
Policy means an insurance policy or contract and includes certificates of fraternal benefit societies, assessment companies, mutual benefit associations, and burials societies (215 ILCS 5/2(n)).

Policyholder
Policyholder means a holder of an insurance policy or contract and includes holders of certificates of fraternal benefit societies, assessment companies, mutual benefit associations, burials societies (215 ILCS 5/2(o)).

Pooling of Risks
An organization of insurers or reinsurers through which particular types of risks are underwritten with premiums, losses, expenses, and profits shared in agreed ratios, generally by unrelated companies in a specific industry that is not economically insurable through traditional insurance companies.

Portfolio Reinsurance
In a transaction of reinsurance, it refers to all the risks of the reinsurance transaction. For example, if one company reinsures all of another’s automobile business, the reinsuring company is said to assume the portfolio of automobile business and it is paid the total of the unearned premiums on all the risks reinsured (less some agreed commission).

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Premium
The consideration or money the insurer receives for the assumption of the hazard or risk of liability.

Risk Retention Group
A corporation or other limited liability association that is organized and licensed to do business as an insurance company under the laws of any one state. It is formed by companies engaged in similar trades and is directly owned by the members, or indirectly owned by an organization that is wholly owned by the members, who are provided self-insurance by the group. Only members can be provided insurance from the risk retention group.

Reinsurance
The process whereby a company may share its risk with other companies by paying a portion of the premiums it receives. For example, Company A assumes insurance from Company B; this is called reinsurance.

Reinsurance Ceded
The process whereby an insurance company known as the ceding company reinsures its liability in whole or in part with a reinsuring company under a contract of reinsurance.

Repurchase Agreements
Under a repurchase agreement, a corporation with excess cash will purchase an obligation from a financial institution or a securities broker. At the time of the purchase, an agreement will be made that the investment is very short-term in nature (generally less than six months but possibly as short as one day). The purchaser agrees to sell the obligations back to the bank or dealer within the specified period of time and the seller agrees to repurchase the obligations. The obligation is usually purchased and resold at a price which is higher than the price the obligation would be traded at on the open market. The higher price represents the original purchase price plus interest for the repurchase agreement period at the current market rate. These can normally be found in Schedule D of the Annual Statement for older years or in the General Interrogatories and Supplemental Investments Risk Interrogatories schedules for more recent years.

Reserve
A sum set aside to insure the company's ability to meet its obligations under its policy contracts, and for various contingencies, such as loss from investment, catastrophic claims, commission liability, claim liability, expense liability and unearned premium liability.

Unauthorized Company
A company not licensed to do business in a state.

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Unauthorized Insurance
Insurance in a company not licensed by the state from which the risk is located.

Unearned Premium
That portion of the premium on a policy or group of policies, which applies to the time that the policy still has to run. The company "earns" its premium as the policy term goes on. The rest is unearned.

Unearned Premium Reserve
Insurance premiums are paid in advance. A company, however, "earns" the premiums only as fast as time elapses. Yesterday's premium is earned. Tomorrow's premium is unearned. The unearned premium reserve is the sum of all unearned premiums of all policies not yet expired that the company has on its books.

Underwriting Profit
Money earned by an insurance company in its underwriting operation as distinguished from money earned in the investment of assets.

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V. EXHIBITS

A. ANNUAL STATEMENTS

Unlike the examinations of retailing and manufacturing corporations, some of the verification and reconciliation of income, modification, and apportionment information for an insurance company can be made by examining the Annual Statements. All insurance companies are regulated by state insurance commissions and are required to file detailed annual financial statements with these regulatory bodies. The financial statements are subsequently verified and audited in considerable detail by the insurance commission examiners of the states in which they do business. The "Annual Statement" or "Convention Form", as it is sometimes called, is a standard form adopted by the National Association of Insurance Commissioners and can be used by the auditors in much the same way as the general ledger and subsidiary books of account for other taxpayers.

The National Association of Insurance Commissioners (NAIC) website only allows the Annual Reports to be obtained for a fee. While the Annual Reports, including the Schedule T, may not significantly change year after year, we are not able to verify that nor does the NAIC inform us of any form changes. For years this Chapter used references to the 1995 Annual Report, and line references needed to be updated to reflect changes in the 2008 Annual Report. Each year may be slightly different, and years subsequent to 2008 may involve new schedules, line references, etc. The auditor will need to be prepared to encounter variations in the Annual Reports when using them.

1. Documentation

Unfortunately we are unable to include images of relevant Annual Reports in this Chapter. Nor would that perhaps be useful, since they may change over time. However, below is a brief summary of some of the exhibits and schedules included in the 2008 Annual Statements of insurance companies where relevant audit financial information may be found. The format, schedules and line numbers may vary in different years.

a) Nonlife Insurance Companies

Assets and Liabilities, Surplus and Other Funds (balance sheet)

Statement of Income

Underwriting and Investment Exhibit- Part 1B Premiums written

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This schedule shows the reinsurance assumed from affiliates and the reinsurance ceded to affiliates.

General Interrogatories
This section contains some general information about the operations of the company.

Schedule D (in general)
This set of schedules should be utilized to verify the addition and subtraction modifications dealing with interest on investments. A description of the various parts follows.

Schedule D- Part 1
This schedule shows all LONG-TERM bonds OWNED on December 31st of the current year.

Schedule D- Part 3
This schedule shows all LONG-TERM bonds and stocks ACQUIRED during the year.

Schedule D- Part 4
This schedule shows all LONG-TERM bonds and stocks SOLD, REDEEMED or otherwise DISPOSED OF during the current year.

Schedule D- Part 5
This schedule shows all LONG-TERM bonds and stocks ACQUIRED during the current years and fully DISPOSED of during the current year.

Schedule DA- Part 1
This schedule shows all SHORT-TERM investments OWNED December 31 of the current year.

Schedule F- Part 1
This schedule shows assumed reinsurance premiums.

Schedule Y- Part 1
This schedule shows the organizational chart for members of a holding company group.

Schedule Y- Part 2
This schedule shows a summary of the insurer's transactions with any affiliates.

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Schedule T
Column #2 of Schedule T shows the direct premiums written for the current year.

The column and line references used above are for Schedule T in the 2008 Annual Statement for non-life insurance companies. The format and line numbers for this schedule may be different in other years.

b) Life Insurance Companies

Assets and Liabilities, Surplus and Other Funds (balance sheet)

Summary of Operations
In some years, Line 1A of this schedule contains information on deposit-type funds that should be included in the apportionment factor. In some years, this information was not reported on Schedule T. For 2008, the summary contains several lines related to deposit-type funds.

Exhibit of Net Investment Income

Exhibit 5 – Interrogatories This section contains some general information about the operations of the company.

Schedule D (in general)
This set of schedules should be utilized to verify the addition and subtraction modifications dealing with interest on investments. A description of the various parts follows.

Schedule D- Part 1
This schedule shows all LONG-TERM bonds OWNED on December 31st of the current year.

Schedule D- Part 3
This schedule shows all LONG-TERM bonds and stocks ACQUIRED during the year.

Schedule D- Part 4
This schedule shows all LONG-TERM bonds and stocks SOLD, REDEEMED or otherwise DISPOSED OF during the current year.

Schedule D- Part 5
This schedule shows all LONG-TERM bonds and stocks ACQUIRED during the current years and fully DISPOSED of during the current year.

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Schedule DA- Part 1
This schedule shows all SHORT-TERM investments OWNED December 31 of the current year.

Schedule S- Part 1
This schedule shows reinsurance assumed.

Schedule Y- Part 1
This schedule shows the organizational chart for members of a holding company group.

Schedule Y- Part 2
This schedule shows a summary of the insurer's transactions with any affiliates.

Schedule T
Schedule T shows the premiums and annuity considerations for the current year. Schedule T shows the direct premiums written for life insurance premiums (Column 2), annuity considerations (Column 3), and accident and health insurance premiums (Column 4). The total direct premiums written for each of these items is reported on Line 59 (Columns 2 through 4). In addition, Schedule T also shows the direct premiums written for company contributions for employee benefit plans (Line 90- Columns 2 through 4), dividends applied to purchase paid-up additions (Line 91- Columns 2 through 4), dividends applied to shorten endowment or premium paying period (Line 92- Columns 2 through 4), premium or annuity considerations waived under disability or other contract provisions (Line 93- Columns 2 through 4), and aggregate other amounts not allocable by state (Line 94 Columns 2 through 4).

The column and line references used above are for Schedule T in the 2008 Annual Statement for life insurance companies. The format and line numbers for this schedule may be different in other years.

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B. LIFE/HEALTH INSURANCE GUARANTY ASSOCIATION TAX OFFSETS

If an insurance company is a member of the Illinois Life and Health Insurance Guaranty Association, the insurance company may be entitled to a Life and Health Insurance Guaranty Association (LHIGA) tax offset on its IL-1120 return.

The Illinois Life and Health Guaranty Association assesses amounts against member insurers when another member-company files for bankruptcy and is unable to meet its obligations to its policyholders. If the total amount of these assessments is higher than the amount prescribed in the statute, members of the Association will be entitled to a tax offset. In some instances, an adjustment to the available offset is made if the Illinois Life and Health Guaranty Association refunds assessments to member insurers after liquidators are able to recover money from a bankrupt member.

1. Statutory Authority For The Tax Offset

The Illinois Income Tax Act does not have a provision that specifically authorizes the Life and Health Insurance Guaranty Association Tax Offset. However, the tax offset is authorized by the Illinois Insurance Code. The Illinois Compiled Statutes (215 ILCS 5/531.13) contain language that describes the offset. Prior to May 29, 1998, 215 ILCS 5/531.13 stated:

> In the event the aggregate Class A, B, and C assessments for all member insurers do not exceed $3,000,000 in any one calendar year, no member insurer shall receive a tax offset. However, in any one calendar year in which the total of such assessments exceeds $3,000,000, the amount in excess of $3,000,000 shall be subject to a tax offset to the extent of 20% of the amount of such assessment for each of the five calendar years following the year in which such assessment was paid and each member insurer may offset the proportionate amount of such excess paid by the insurer against its liabilities for the tax imposed by subsections (a) and (b) of Section 201 of the "Illinois Income Tax Act", for the tax imposed by Section 409 of the "Illinois Insurance Code", and for the fees imposed by Section 408.1 of the "Illinois Insurance Code.

Public Act 81-899, which was effective on January 1, 1980, initially authorized members of the Illinois Life and Health Guaranty Association to claim an offset against their income <u>and</u> replacement tax liabilities. Effective September 1, 1985, this was subsequently amended by Public Act 84-221 so that for Illinois income tax purposes members of the Illinois Life and Health Guaranty Association can only claim the offset against their <u>income</u> (not replacement) tax liability.

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A legislative change was made to the Insurance Code effective January 1, 1998, to eliminate the inequity of premiums tax assessments between in-state and out-of-state insurance companies, making the applicable premiums tax rate 0.4% for accident insurance companies and 0.5% for all other insurance companies. This, in effect, has reduced the amount of overall premiums tax liability.

Effective May 29, 1998, Public Act 90-583 amended 215 ILCS 5/531.13 to state:

> In the event the aggregate Class A, B and C assessments for all member insurers do not exceed $3,000,000 in any one calendar year, no member insurer shall receive a tax offset. However, for any one calendar year before 1998 in which the total of such assessments exceeds $3,000,000, the amount in excess of $3,000,000, shall be subject to a tax offset to the extent of 20% of the amount of such assessment for each of the 5 calendar years following the year in which such assessment was paid and each member insurer may offset the proportionate amount of such excess paid by the insurer against its liabilities for the tax imposed by subsections (a) and (b) of Section 201 of the Illinois Income Tax Act. The provisions of this Section shall expire and be given no effect for any tax period commencing on and after January 1, 2003.

The LHIGA Tax Offset cannot be claimed for any tax period commencing on and after January 1, 2003.

2. Claiming The Tax Offset

The Illinois Department of Insurance provides premium data to the Illinois Life and Health Guaranty Association to enable it to calculate the amount of the assessments against its members. Based on this information, the Illinois Life and Health Guaranty Association provides each member a statement (Tax Offset Notice) indicating the potential amount available for a tax offset in the current tax year. In addition, the Tax Offset Notice also provides the member the amount available for a tax offset in prior years.

Prior to May 29, 1998, 215 ILCS 5/531.13 allowed an insurance company to claim the Life and Health Insurance Guaranty Association Tax Offset against EITHER its income tax liability, premium tax liability under Section 409 of the Illinois Insurance Code, or fees imposed by Section 408.1 (fees for valuation of life insurance policies) of the Illinois Insurance Code. The insurance company has the option to decide where the tax offset will be claimed. The offset is available only to the paying company. It may not be transferred or assigned to any other company. In addition, no offset may be taken for any assessments issued by the Life and Health Insurance Guaranty Association that have not been paid by the company.

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If the amount of the tax offset exceeded the tax or fees due for one of the above items and the insurance company decided to claim the tax offset against that item, the insurance company could claim the remaining portion of the tax offset against another tax or fee. In other words, a company's available tax offset could be used to reduce taxes and fees due to the Illinois Department of Insurance and/or the Illinois Department of Revenue. However, the combined value of all the tax offsets taken may not exceed the total available tax offset computed by the Illinois Life and Health Guaranty Association.

Unlike losses and credits, there are no provisions to carry any excess or unused LHIGA tax offsets. If the amount of the tax offset exceeds the amount of all of the above taxes and fees, the excess tax offset may NOT be carried back or forward. In addition, if a tax offset is available, but is not taken by the insurance company in the year it becomes available; it may not be carried back or forward. The only two situations when the excess amount can be utilized at a later date would be when there has been either an Illinois or a federal change to the tax year. If an insurance company's tax liability was increased as a result of an Illinois audit or an IL-1120-X, it would be able to utilize any excess amount of LHIGA Tax Offset that had not previously been utilized on the taxpayer's original return for that year. Further, if the total amount of LHIGA Tax Offset had not been utilized in the current year and a federal audit or federal amended return increased the insurance company's Illinois tax liability it would be able to utilize the excess amount of LHITA Tax Offset that had not previously been claimed.

For tax years ending after May 29, 1998, taxpayers can claim the LHIGA Tax Offset against the liabilities imposed by IITA § 201 (a) and (b) (215 ILCS 5/531.13) AND on their Privilege and Retaliatory Tax return (215 ILCS 5/444(3)).

For tax years ending after May 29, 1998, auditors will no longer be required to determine how much, if any, LHIGA Tax Offset a taxpayer has claimed on their Privilege and Retaliatory Tax returns. As discussed below under VERIFYING THE TAX OFFSET, auditor’s will only have to verify that the correct amount of LHIGA Tax Offset reported on the Tax Offset Notice by the Life and Health Insurance Guaranty Association has been claimed on the Illinois Income Tax return.

Example #41

For the year ending December 31, 1995, insurance company B owes Illinois Privilege (premiums) Tax of $500,000 (before any credits), Illinois Income Tax of $200,000 (this represents income tax only and is after any credits), and $100,000 for fees imposed by Section 408.1 of the Illinois Insurance Code. The Illinois Life and Health Insurance Guaranty Association provides information to B stating that B is entitled to a Life and

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Health Guaranty offset of $75,000. B decides to claim the tax offset of $75,000 against its premiums tax liability. In this case, B will NOT be able to claim a tax offset against its income tax liability.

Example #42

For the year ending December 31, 1995, insurance company C owes Illinois Privilege (premiums) Tax of $300,000 (before any credits), Illinois income tax of $100,000 (this represents Income Tax only and is after any credits), and $25,000 for fees imposed by Section 408.1 of the Illinois Insurance Code. The Illinois Life and Health Insurance Guaranty Association provides information to C stating that C is entitled to a Life and Health Guaranty offset of $75,000. C decides to claim $25,000 of the tax offset against the fees imposed by Section 408.1 of the Illinois Insurance Code and the remainder of the tax offset against his income tax liability. In this case, C will only be able to claim a $50,000 tax offset against its income tax liability.

Example #43

For the year ending December 31, 1998, insurance company D reported an LHIGA Tax Offset of $100,000 on its Privilege and Retaliatory Tax Statement (Page 4- line 7b- column 1). The computation of Retaliatory taxes on page 4 shows that the insurance company had a total Illinois basis (line 9- column 1) of $500,000 and a total state of incorporation basis of $800,000 (line 10- column 2). This resulted in a Retaliatory tax due (line 11- column 2) of $300,000 (state of incorporation basis (line 10- column 2) minus the total Illinois basis (line 9- column 1)).

In addition, the taxpayer has claimed an LHIGA Tax Offset of $100,000 against its corporate income tax liability. The taxpayer is allowed to claim the LHIGA Tax Offset against BOTH the Illinois Income Tax AND its Privilege and Retaliatory Tax. No adjustment should be made to D's Illinois Income Tax return.

According to the IL-1120 instructions, an insurance company entitled to this tax offset should identify it by writing "LHIGA" in the margin to the left of line 4(a) of Part V of the IL-1120. In some situations, recoveries from liquidators can result in a subsequent refund to member companies of previously paid assessments. This can result in the member companies being required to "recapture" all or a portion of a previously claimed credit. Any amounts recaptured on an IL-1120 return should be shown on line 8(b) of part IV. Writing "LHIGA" in the margin should identify the amount.

It is important to note, however, that the statute considers this an offset against *liability* for the tax imposed, and not as a credit or an *offset* against the *tax*. The Illinois income tax must first be reduced by any available credits against the tax. After the application

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of credits, if any liability remains, the appropriate offset may be utilized. In other words, the LHIGA offset is merely a mechanism for payment of the Illinois income tax.

3. Verifying The Tax Offset

The Life and Health Guaranty Association maintains records for the purpose of determining the amount assessed against each insurance company, the amount paid by each insurance company, and the date of payment of the assessment. If a Life and Health Insurance Guaranty Association Tax offset is claimed on the IL-1120 return, the auditor should:

- Verify the tax offset claimed was correct by reviewing the Tax Offset Notice provided to the member insurer by the Illinois Life and Health Insurance Guaranty Association;

- For tax years ending on or before May 29, 1998, verify the tax offset amount has not also been claimed against the insurance company's premiums tax, retaliatory tax, or the fees imposed by Section 408.1 of the Illinois Insurance Code; and

- Verify any amounts that need to be recaptured on the IL-1120.

The auditor can verify the second bulleted item above by requesting the returns filed with the Department of Insurance from the taxpayer.

The auditor can verify the third bulleted item above (recapture amount) by performing the following calculation:

- Subtract the sum of the LHIGA offsets taken against Illinois taxes in prior years (per prior IL-1120 returns) from the amount of offset available for prior years (shown on the Tax Offset Notice);

- Determine if the result is negative, positive or zero. Continue with the calculation only if the result is negative, representing an excess tax offset taken in prior years; and

- Compare the result from step #1 above to the offset available in the current year (per the Tax Offset Notice). A recapture is necessary on the current year return if the amount from step #1 is greater than the offset available in the current year. The amount to be recaptured is the difference between these two amounts.

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C. QUESTIONNAIRE 1

The following questionnaire primarily addresses determining if a company qualifies as a captive insurance company, and also includes questions aimed at establishing if Illinois nexus exists and gaining other business-related information. The questions are classified under nine categories.

Business Operations

1. Is CAPTIVE INSURANCE COMPANY's primary and predominant business activity, during the audit years, the issuance of insurance contracts within the meaning of IRC § 816(a)?

2. What are its sources of revenue in each audit year? What is the ratio of non-premium income to total income for each audit year?

3. Whom does CAPTIVE INSURANCE COMPANY insure? Does the CAPTIVE INSURANCE COMPANY insure only the parent company, or does it insure the other subsidiaries as well? Please provide a list of the insured and a list of who paid premiums to CAPTIVE INSURANCE COMPANY during the audit period.

4. How does CAPTIVE INSURANCE COMPANY shift risk?

5. How does CAPTIVE INSURANCE COMPANY distribute risk?

6. Were the insurance contracts issued by CAPTIVE INSURANCE COMPANY qualified as binding insurance contracts with terms and conditions commonly used in the insurance industry?

7. Are operations and assets of CAPTIVE INSURANCE COMPANY and parent separate?

Claims

1. Provide copies of all documents that discuss, relate to, or concern how claims for losses incurred and the claims process have been established between parent/subsidiaries and CAPTIVE INSURANCE COMPANY.

2. What process is followed to pay the insurance claims? Are they paid out of funds that are separate from the parent?

3. Is the validity of a claim established before the claim is paid?

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4. Please identify the funds used to pay insurance claims. What is the source of the monies in these funds?

5. Provide copies of all documents that discuss, relate to, or concern how the third-party administrator handles deductible reimbursement claims. If a third party was used, to whom did the third-party administrator submit its invoices for payment?

6. Does anyone from parent and its subsidiaries approve the payment of any claims? If yes, who?

Federal Tax Treatment

1. Provide a copy of federal Form 1120-PC and all attachments filed by CAPTIVE INSURANCE COMPANY for the audit years, if not already provided.

2. Was CAPTIVE INSURANCE COMPANY treated as an insurance company on the federal consolidated return?

3. Do the premiums reported on the federal return properly qualify as insurance premiums under IRS rules and regulations?

4. Did parent or other subsidiary take a deduction for premiums expense on its federal tax return?

5. Did CAPTIVE INSURANCE COMPANY report those premiums as income on its federal tax return?

6. Were the premiums charged by CAPTIVE INSURANCE COMPANY and premiums expensed for charges from CAPTIVE INSURANCE COMPANY to parent and its subsidiaries eliminated from consolidated federal taxable income in each audit year?

7. Was CAPTIVE INSURANCE COMPANY's loss reserve deducted on the federal return filed for each audit year?

8. During the IRS examination of the audit year(s) federal returns, was the issue of CAPTIVE INSURANCE COMPANY's status as an insurance company addressed in the audit? If yes, please provide copies of all documents that discuss, relate to, or concern the results of the federal examination in regard to its status as an insurance company for federal purposes.

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Formation

1. Please provide copies of all documents that discuss, relate to, or concern the formation of CAPTIVE INSURANCE COMPANY including all engagement letters, proposals, feasibility plans, etc.

2. Did the use of CAPTIVE INSURANCE COMPANY coverage replace any insurance coverage that existed at the time coverage was implemented? If yes, please provide copies of all documents that discuss, relate to, or concern the cancellation of insurance coverage.

3. Was there an outside influence that led to the formation of CAPTIVE INSURANCE COMPANY? Were any existing policies not renewed or subject to a premiums increase? If yes, please describe the circumstances and provide copies of all documents that discuss, relate to or concern the non-renewal/increase in premium of insurance coverage.

Operation

1. Please provide a list of the risks assumed, with associated dollar limits, by entity for each CAPTIVE INSURANCE COMPANY insurance contract in force during the audit period.

State Regulation

1. Is CAPTIVE INSURANCE COMPANY regulated as an insurance company in each state in which it does business? Is it licensed in each state where it is said to insure risk?

2. Provide a copy of STATE Captive Insurance Company Application for Admission or other applicable state form and attachments.

3. Did the STATE Department of Insurance approve or establish the premium rate for insurance between the parent/subsidiaries and CAPTIVE INSURANCE COMPANY? Provide copies of all documents that discuss, relate to or concern the approval or establishment of the premium rate for insurance by the state authority between the parent/affiliates and CAPTIVE INSURANCE COMPANY.

4. If CAPTIVE INSURANCE COMPANY is licensed in a single state yet insures risks in other states why did it not obtain licensing in these other states?

5. Provide copies of all documents that discuss, relate to, or concern how CAPTIVE INSURANCE COMPANY is subject to regulation by state insurance regulators.

6. Did CAPTIVE INSURANCE COMPANY pay the appropriate premium tax?

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7. Did CAPTIVE INSURANCE COMPANY pay an assessment to the appropriate state guarantee funds?

8. Did CAPTIVE INSURANCE COMPANY treat amounts received as premium income on its NAIC Annual Statement filed with the state insurance regulator?

9. Please provide a copy of the NAIC Annual Statement filed with the state insurance regulator for each audit year.

10. Did the STATE Department of Insurance require a payment to a state insurance company guarantee fund? If yes, were such payments made for the audit period?

11. Did the STATE Department of Insurance require a payment of a tax based on premiums in the audit period? If yes, were such payments made by CAPTIVE INSURANCE COMPANY?

12. For the audit period, did CAPTIVE INSURANCE COMPANY fully meet all of the requirements of the STATE Department of Insurance to be an insurance company in good standing?

13. Was CAPTIVE INSURANCE COMPANY subject to any disciplinary action by the STATE Department of Insurance during the audit period? If yes, please describe the circumstances and the actions taken by the STATE Department of Insurance.

Capitalization

1. Please explain how CAPTIVE INSURANCE COMPANY was capitalized and why this method of capitalization was chosen. Provide copies of all documents that discuss, relate to, or concern as to how and why this method of capitalization was chosen for CAPTIVE INSURANCE COMPANY.

2. How were the capital requirements of CAPTIVE INSURANCE COMPANY determined and how were these capital requirements met?

3. Provide copies of all documents that discuss, relate to, or concern how CAPTIVE INSURANCE COMPANY engages in investment activities.

4. Provide copies of all documents that discuss, relate to, or concern the source of funds used by CAPTIVE INSURANCE COMPANY in its investments.

5. Was the capitalization method and amount approved by the insurance regulators?

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Please provide documentation.

6. Please provide copies of all documents that discuss, relate to, or concern how these assets were found to be proper and sufficient for the risks insured by CAPTIVE INSURANCE COMPANY.

Premiums

1. How were the values of the premiums charged determined? Please provide copies of all documents that discuss, relate to, or concern as to how the premiums amounts were determined.

2. How did the premiums charged get paid by the insureds? Please provide documentation that shows that the premiums charged were paid and how the premiums were paid.

3. Were premiums charged reviewed and/or changes at any time after initial premium was determined and the contracts were initially established? If yes, provide copies of all documents that discuss, relate to, or concern the premiums review and/or change.

4. Provide a list of the type of risk insured and the premiums related to each risk paid to CAPTIVE INSURANCE COMPANY by parent and affiliates for the audit years.

5. Provide a list of the type of risk insured and the premiums related to each risk paid to unrelated commercial insurance carriers for the audit years.

6. Provide copies of all documents that discuss, relate to, or concern whether the insured's have paid an arm's-length premium for the insurance protection provided under the various policies of insurance issued by CAPTIVE INSURANCE COMPANY.

7. Please provide a copy of the actuarial studies used to determine the premiums charged in each audit year.

Guarantees

1. Is the income of CAPTIVE INSURANCE COMPANY guaranteed by the parent or any other member of the group? If yes, please describe the circumstances.

2. Were any indemnification, hold harmless, or other types of guarantees entered into with CAPTIVE INSURANCE COMPANY by the parent or its subsidiaries? If yes, please describe the agreements and provide all documents related to these agreements.

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D. QUESTIONNAIRE 2

The following questionnaire primarily addresses establishing if Illinois nexus exists, and also includes questions aimed at determining if a company qualifies as a captive insurance company and other business-related information.

1) For the Tax Years at Issue, identify the name(s) and the business addresses of the entity(ies) that received insurance from CAPTIVE INSURANCE COMPANY:
   a.) The physical location where the entity(ies) were located;
   b.) The type of insurance that was purchased;
   c.) Names and addresses of the persons involved in the purchase of the insurance;
   d.) The name of the financial institution(s) and account number(s) where insurance premiums were paid from and the name of the financial institution(s) and account number(s) into which insurance premiums were paid.

2.) During the Tax Years at Issue, did any of parent's/affiliates of parent's employees, officers, directors, managers, agents perform work and/or services on claims for CAPTIVE INSURANCE COMPANY? Services include, but are not limited to taking/creating claims, investigating claims, handling claims, litigating/prosecuting claims and administering claims. If so:
   a.) Please list their name, job title, job description, location;
   b.) Please describe the work or service performed;
   c.) Please describe how the particular individual was compensated;
   d.) Please list the documents generated that tracked and account for the time and expense expended on the work or services performed.

3.) During the Tax Years at Issue, did any third party perform work and/or services on claims for CAPTIVE INSURANCE COMPANY? Services include, but are not limited to taking/creating claims, investigating claims, handling claims, litigating/prosecuting claims and administering claims. If so:
   a.) Please list their name(s) and business addresses;
   b.) Please describe the work or service performed, where it was performed, and by whom;
   c.) Please describe how the particular third party was compensated.

4.) During the Tax Years at Issue, did any third party perform any work and/or services other than the actual handling of claims for CAPTIVE INSURANCE COMPANY? If so:
   a.) Please list their name(s) and business addresses;
   b.) Please describe the work or service performed, where it was performed, and by whom;
   c.) Please describe how the particular third party was compensated.

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5.) With regard to the CAPTIVE INSURANCE COMPANY:
a.) Please list their name, job title and job description of persons who deal or have any connection with the insurance agreements;
b.) Please describe the work or service performed in a.) above;
c.) Indicate the location(s) where the work or service is performed;
d.) Please describe how the particular individual was compensated in a.) above;
e.) Please list the documents generated that tracked and account for the time and expense expended on the work or services performed in a.) above.

6.) For the Tax Years at Issue, identify any of the following services that parent provided to CAPTIVE INSURANCE COMPANY:
a.) Insurance;
b.) Advertising services;
c.) Accounting services;
d.) Bookkeeping services;
e.) Services related to insurance claims;
f.) Research/development;
g.) Strategic planning;
h.) Purchasing, please include in your common suppliers of goods or equipment;
i.) Office or warehouse space;
j.) Guarantee of leases, bonds, loans, financing;
k.) Financing, including short-term borrowing, long-term borrowing, and loan guarantees;
l.) Personnel;
m.) Procurement, negotiation, coordination, oversight of all contracts and agreements with independent contractors;
n.) Any other services provided by parent/affiliate of parent to CAPTIVE INSURANCE COMPANY

7.) For each of the Tax Years at Issue, please list every U.S. state, city, county, municipality or locality wherein CAPTIVE INSURANCE COMPANY filed a tax return. Please list any and all state and local tax returns.

8.) For the Tax Years at Issue, please describe in detail any intercompany loans involving CAPTIVE INSURANCE COMPANY. Please include in your response:
a.) The name of the individual, the name of his/her employer, job title, and job descriptions for those involved in the creation and maintenance of transactions;
b.) Describe how that individual was paid, e.g. straight salary, salary/commission, or commission only;
c.) If an independent contractor, the name of the individual/entity, address of business;
d.) The dollar amount outstanding for each Year at Issue and the interest paid for each Tax Year at Issue

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9.) For the Tax Years at Issue, describe in detail how the insured pay their premiums to CAPTIVE INSURANCE COMPANY. In your response describe the frequency at which premiums were paid and state whether cash was transferred or payment represented a book entry.

10.) For the Tax Years at Issue, please list the name of the financial institution(s) and account number(s) of the custodial account where CAPTIVE INSURANCE COMPANY. held substantially all of its cash and cash equivalents in the U.S..

11.) Identify all claims paid by CAPTIVE INSURANCE COMPANY. during the Tax Years at Issue.

12.) During the Tax Years at Issue, list all of the employees and property of CAPTIVE INSURANCE COMPANY.

13.) For the Tax Years at Issue, please list all of the policy number(s), type(s), and insurance companies that CAPTIVE INSURANCE COMPANY's policies followed in its policies with parent/affiliates of parent.

14.) Identify the names, titles, business addresses of all individuals involved directly or indirectly in the preparation of the CAPTIVE INSURANCE COMPANY's Illinois tax returns and amended returns for Tax Years at Issue. Please give a brief description of each person's involvement.

15.) Did CAPTIVE INSURANCE COMPANY. maintain any bank accounts? If so, please list the name of the financial institution and the bank account number(s).

16.) State all total annual "direct premiums" CAPTIVE INSURANCE COMPANY received on insurance policies written for insurance on policies or risk everywhere, as explained in IITA § 304(b)(1).

17.) State whether CAPTIVE INSURANCE COMPANY is engaged in "reinsuring" as defined by IITA § 304(b)(2). If so:
   a.) State the premiums written for reinsurance accepted in respect of property or risk in Illinois.
   b.) State the premiums written for reinsurance accepted in respect of property or risk everywhere.

18.) Please produce all documents relating to Answers 1.) through 17.) above.

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19.) Please produce all insurance contracts and policies issued by or on behalf of CAPTIVE INSURANCE COMPANY during the Tax Years at Issue, including policies related to worker's compensation, general liability, auto liability, auto physical damage, property, crime liability, general liability, business interruption and excess liability.

20.) Please produce all documents evidencing any loans by/from CAPTIVE INSURANCE COMPANY to/from parent/affiliates of parent in effect for the Tax Year at Issue.

21.) Please produce all documents evidencing any premium receivable by/to CAPTIVE INSURANCE COMPANY and from Parent/affiliates of Parent in effect for the for the Tax Period at Issue.

22.) Please submit all documentation showing insurance claims made by parent/affiliates of parent for the Tax Year at Issue.

23.) Please submit all copies of invoices for premiums charged by CAPTIVE INSURANCE COMPANY for the Tax Year at Issue.

24.) Please produce all documents related to and including contracts, agreements. purchase orders by CAPTIVE INSURANCE COMPANY and/or parent/affiliates of parent with any third party for the administration of claims for the Tax Year at Issue.

25.) Please produce any and all management services agreements in effect during the Tax Years at Issue between parent/affiliates of parent and CAPTIVE INSURANCE COMPANY (even if the agreement was entered into prior to the Tax Years at Issue), including any service or management agreement(s).

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TRANSPORTATION COMPANIES
Issued August 2016
Revised January 2020

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I. PURPOSE

This chapter discusses IITA § 304(d) which contains a special apportionment formula for "[b]usiness income derived from furnishing transportation services."

For Illinois purposes transporting may occur by air, land, water, or through a pipeline.

II. REFERENCE

Illinois Income Tax Act (IITA)
- IITA § 304(d)

Illinois Regulations (IAC)
- IAC § 100.3450 Apportionment of Business Income of Transportation Companies
- IAC § 100.9715 Transportation Companies

III. TRANSPORTATION COMPANIES AND NEXUS

Similar to all service companies, nexus for a transportation company is not limited by PL 86-272. Nexus is created if the transportation company has activities in Illinois and those activities result in a portion of the company's business income being apportionable to Illinois.

The Department's position is that it is immaterial whether or not deliveries are made into Illinois. If the taxpayer transports freight or passengers through Illinois, nexus is created and the taxpayer is considered as providing transportation services in Illinois. Witte Brothers Exchange, Inc. v. DOR, 997 N.E.2d 903 (1st Dist. 2013).

IV. APPORTIONMENT

A. <u>For taxable years ending on or after December 31, 2008:</u>

Business income derived from <u>*providing transportation services*</u> other than airline services shall be apportioned to this State by using a fraction

Numerator:
- All receipts from any movement or shipment of people, goods, mail, oil, gas, or any other substance (other than by airline) that both originates and terminates in this State, plus

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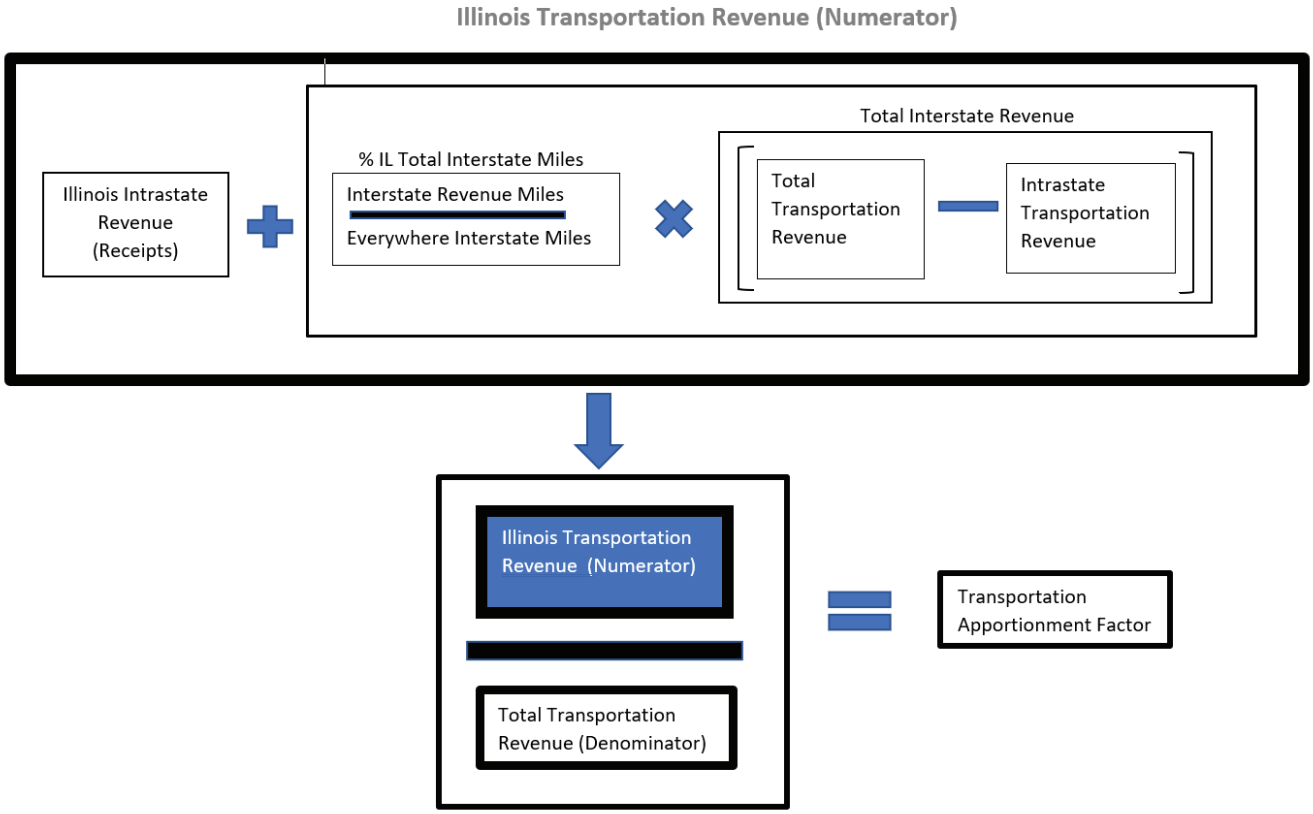
- Any portion of the person's gross receipts from movements or shipments of people, goods, mail, oil, gas, or any other substance (other than by airline) that originates in one state or jurisdiction and terminates in another state or jurisdiction, that is determined by the ratio that the miles traveled in this State bears to total interstate miles everywhere.

Denominator:
- All revenue derived from the movement or shipment of people, goods, mail, oil, gas, or any other substance (other than by airline) Ref: IITA § 304(d)(3)

Business income derived from *furnishing airline transportation services* shall be apportioned to this State by multiplying that income by a fraction,

Numerator:
- Revenue miles (see below) of the person in this State, and the

Denominator:
- Revenue miles of the person everywhere.



REF: IITA § 304(d)(4)

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1. Revenue mile

- the transportation of one net ton of freight the distance of one mile for consideration;
- the transportation of one passenger the distance of one mile for consideration;
- the transportation by pipeline of one barrel of oil the distance of one mile for consideration;
- the transportation by pipeline of one thousand cubic feet of gas the distance of one mile for consideration; or
- the transportation by pipeline of any specified quantity of a substance other than oil or gas the distance of one mile for consideration. (IITA Section 304(d)(1) and (4))
- "in this State" - transportation occurs within the geographic boundaries of the State of Illinois.
    - In the case of interstate transportation by land, the revenue miles or miles traveled in this State are the miles determined under IAC § 100.3450 subparagraph (b)(1)(A) between the point or points where the route used in determining those miles intersect the Illinois border and the point, if any, in Illinois where the route begins or ends.
    - In the absence of evidence to the contrary, the number of miles of transportation within this State by a vessel operating on water that is not wholly within or without this State shall be 50% of the total number of transportation miles on that water.
    - In the case of interstate transportation by airline, the revenue miles in this State are the miles determined under IAC § 100.3450 subparagraph (b)(1)(D) between the point where the route used in determining those miles intersects the Illinois border and the airport in Illinois where the flight begins or terminates. Revenue miles in a flight that neither begins nor terminates in Illinois ("flyover miles") may not be included in the numerator. Northwest Airlines, Inc. v. Department of Revenue, 295 Ill. App. 3d 889, 692 N.E.2d 1264 (1998), *appeal denied*, 179 Ill. 2d 589, 705 N.E. 2d 440.

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2. Transporting People and Freight

When a transportation company is in the business of transporting people and freight IITA § 304(d)(1)(A), (B) and (2) provide for a slight variation in the above formula. The revenue mile fraction from each area of the business is weighed based on the relative gross receipts and then averaged to arrive at the apportionment formula.

The calculations used to accomplish this follow:

1. Revenue passenger miles in Illinois/Revenue passenger mile everywhere
2. Revenue freight miles in Illinois/Revenue freight miles everywhere
3. Passenger receipts + Freight receipts = Gross receipts
4. Passenger receipts/Gross receipts
5. Freight receipts/Gross receipts
6. (1 * 4) + (2 * 5) = Apportionment Formula

The method of determining and verifying the correct amount of revenue miles that should be included in the apportionment formula varies with each type of transportation company.

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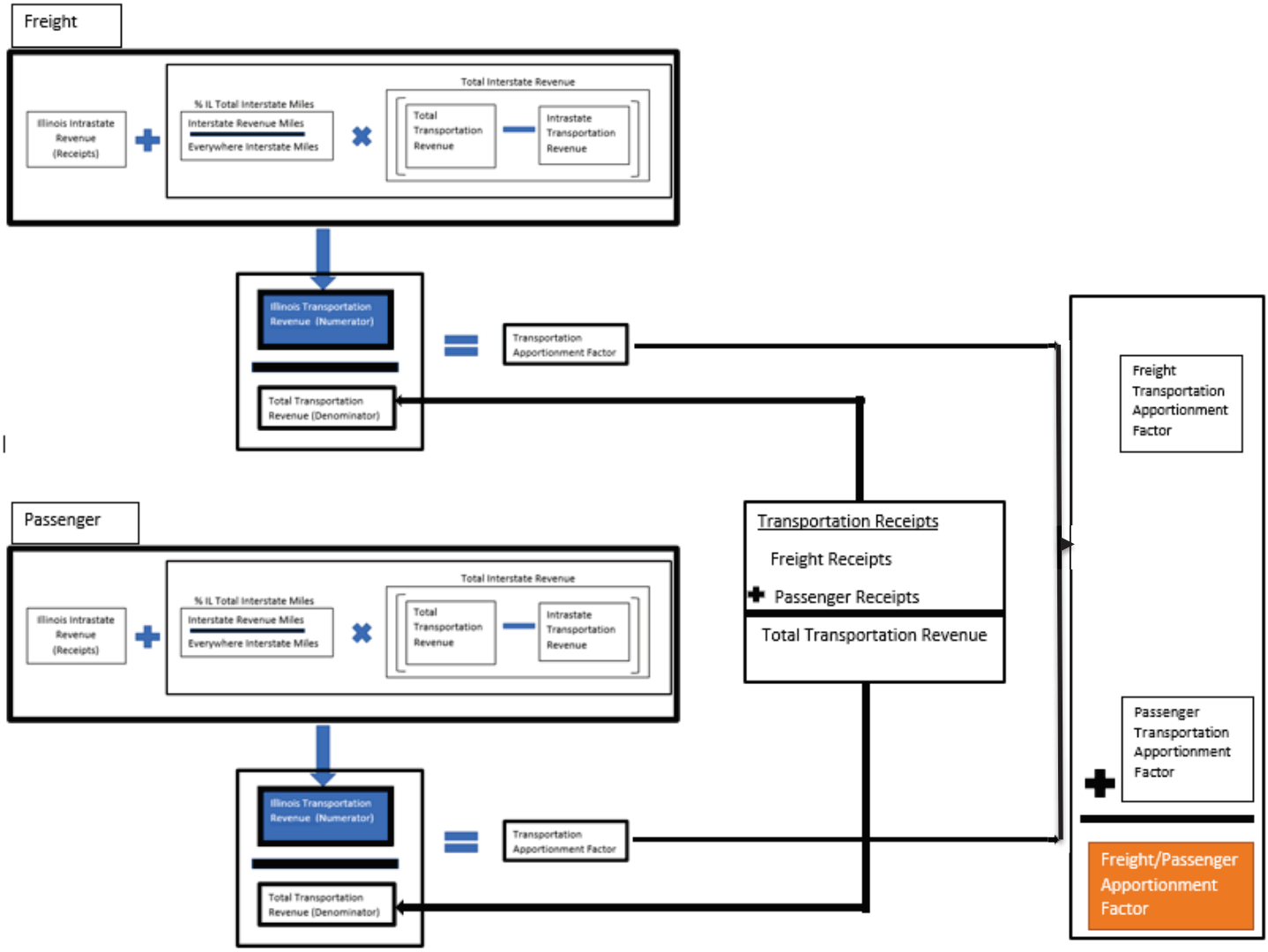

3. Transport by Land

a) Trucking

Companies in the motor freight industry tend to use revenue highway miles instead of revenue miles in their apportionment formula computations. Unless the taxpayer maintains specific records of miles or routes actually traveled by a vehicle in a particular trip, the miles transported or traveled is the standard distance in miles between the points of pickup and delivery. The formulas for these companies should be adjusted to include revenue miles if at all possible since using revenue highway miles may result in empty miles being included in the formula. If it is impossible to convert the

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highway miles to revenue miles, every effort should be made to identify and eliminate empty miles from the factors. Empty miles are also known as "deadhead" or "bobtail" miles. Distances may be rounded to the nearest mile.

Note: If you need total miles driven and total miles driven in each state; Sales Tax Technical Support can obtain the information for you.

b) Trains

Railroads can also be involved in transporting passengers and/or freight and can, therefore, be using the variation of the apportionment formula for dual capacity carriers. In the case of the railroads, their weighted portion of the fraction of freight revenue versus passenger revenue.

c) Trip Lease Load

A letter ruling issued by the Department on April 14, 1980 gives the following example of a trip lease load and explains its effect on the apportionment formulas of the lessor and the lessee:

> A lessee ("A") is contacted in its Indianapolis office by a customer who wishes to have a load of freight brought from Des Moines, Iowa to Indianapolis. A contact's its lessor ("B"), another Indiana based motor carrier, in Des Moines, where B has just delivered a load of freight and is waiting with an empty truck. B accepts the lease offer, picks up A's customer's load in Des Moines and brings it to Indianapolis. The customer pays A for the transportation services rendered; A pays B (presumably a lesser amount) for the transportation services rendered by B to A. The miles driven by the lessor due to the trip lease load are included in the total revenue miles of both the lessor and the lessee. The miles driven in Illinois are included in the Illinois numerator of both the lessor and the lessee.

Therefore, it is not necessary to detail the miles driven from each of the following types of transactions separately:

- The taxpayer deals directly with the customer and does the actual hauling.
- The taxpayer is the lessor of the trip lease load and does the hauling but does not deal directly with the customer.
- The taxpayer is the lessee of the trip lease load and deals directly with the customer but does not do the actual hauling.

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Examples

Example 1

During its taxable year ending December 31, 2008, Transportation Company made the following trips transporting goods on behalf of its customers:

	Miles Traveled			
Trip:	Outside-Illinois	Within Illinois	Total	Gross Receipts
Iowa to Minnesota	600	0	600	$700
Iowa to Wisconsin	400	0	400	300
Iowa to Illinois	50	140	190	400
Iowa to Indiana	50	300	350	600
Iowa Intrastate	220	0	220	320
Illinois Intrastate	0	200	200	400
Totals	1,320	640	1,960	$2,720
Less IA Intrastate	(220)	0	(220)	($320)
Less IL Intrastate	0	(200)	(200)	($400)
Interstate Totals	1,100	440	1,540	$2,000

Based on the above, Transportation Company's apportionment factor is 35.6985%, computed as follows:

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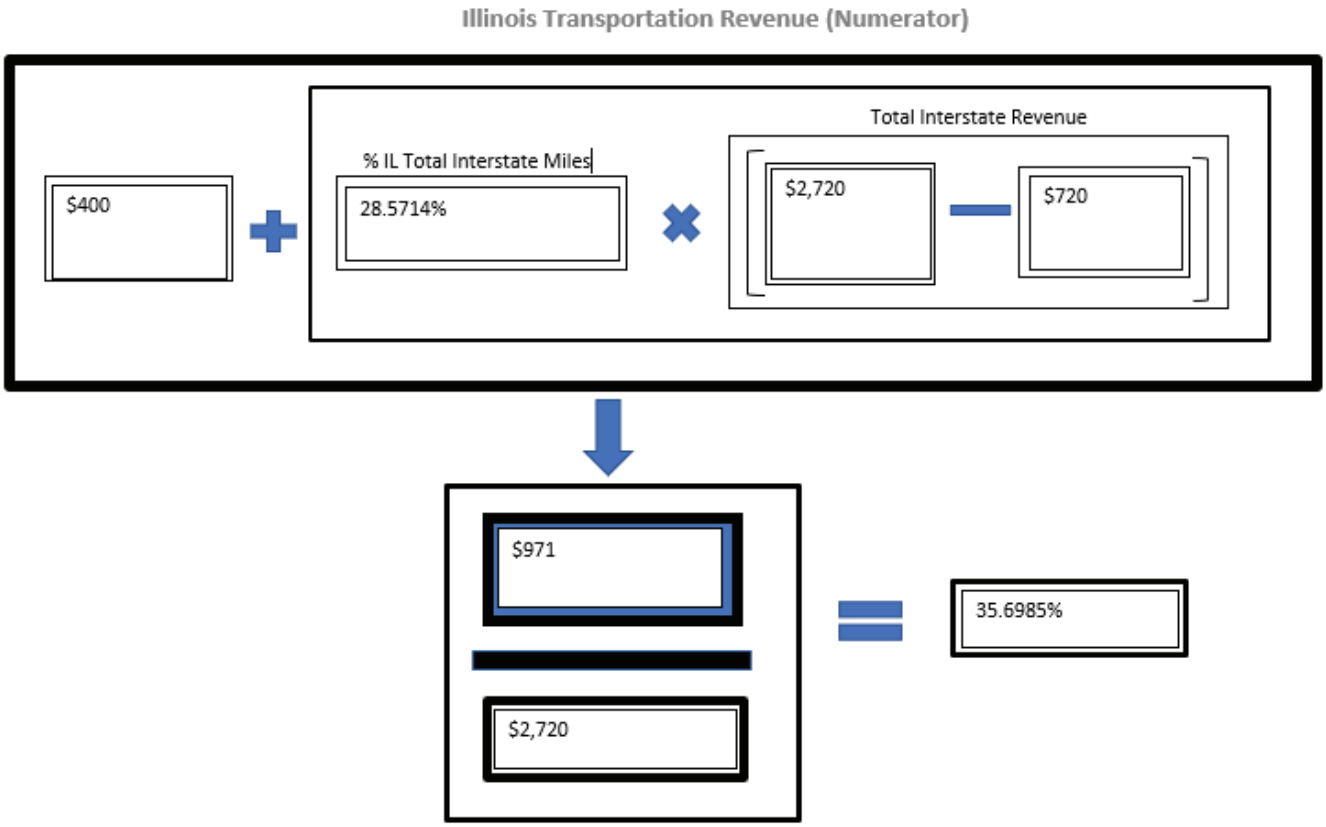
	ILLINOIS NUMERATOR			
	Miles Traveled			
Trip:	Outside-Illinois	Within Illinois	Total	Gross Receipts
Totals	1,320	640	1,960	$2,720
Less Iowa Intrastate	(220)	0	(220)	(320)
Less Illinois Intrastate	0	(200)	(200)	(400)
Interstate	1,100	440	1,540	$2,000
Illinois Intrastate Receipts				$400
Illinois Interstate Miles		440		
Everywhere Interstate Miles		1,540		
Fraction IL/Everywhere Miles		28.5714%		
Interstate Receipts		$2,000		
Illinois Share of Interstate Receipts				571
Numerator				$971
DENOMINATOR				
Total Receipts				$2,720
FACTOR				
Numerator/ Denominator				35.6985%



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The numerator is the $400 in gross receipts from the trip that both originated and terminated in Illinois, plus the $571 Illinois portion of gross receipts from interstate trips. The $571 Illinois portion of gross receipts from interstate trips is computed by multiplying the $2,000 in total gross receipts from those trips by a fraction equal to the 440 miles traveled in Illinois in those trips divided by the 1,540 in total miles traveled during those trips. The 35.6985% factor is the $971 numerator divided by the $2,720 in gross receipts for all trips.

Example 2:

Taxpayer transports freight and passengers by railroad with total income of $100. Taxpayer derived $60 in operating income from transporting freight, $30 in operating income from transporting passengers and $10 in income from non-transportation activities. Taxpayer's apportionment fraction for its freight transportation business is 15% and its apportionment fraction for passenger transportation is 45%. Taxpayer's apportionment factor is 25%, computed as follows: 15% times ($60/$90) plus 45% times ($30/$90). See below for how apportionment factor was calculated.

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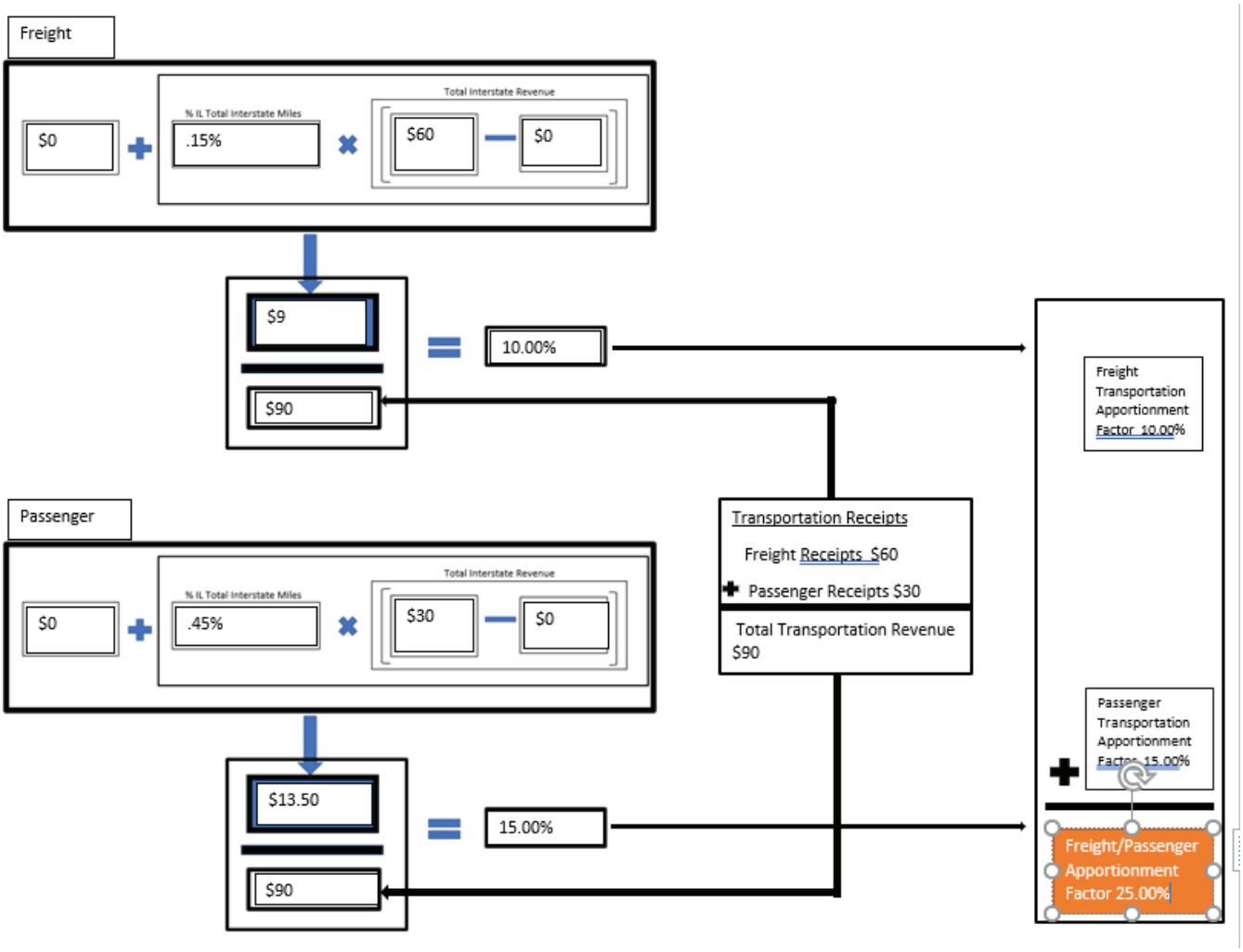
	Col A	Col B	Col C	Col D	Col E
			Apportion-		
		Operating	ment		IL Factor
	Income	Income	Fraction	Weighting	C times D
Transporting freight	$60	$60	15.00%	(60/90)	10.00%
Transporting passenger	$30	$30	45.00%	(30/90)	15.00%
Non-transportation receipts	$10	$0	0.00%	0	0.00%
Sub Totals	$100	$90	~~	~~	25.00%



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Example 3:

Taxpayer transports freight by air and ground service for its taxable year ending June 30, 2009. Taxpayer uses trucks to provide its ground transportation services. Taxpayer has total gross receipts of $1,600. Taxpayer derived $600 from transporting freight by truck and $1,000 from transporting freight by air. Using the gross receipts methodology set forth in IAC § 100.3450 subsections (a)(2)(A) and (c), Taxpayer's apportionment factor for its ground transportation services is 12%. Using the revenue miles methodology in IAC § 100.3450 subsection (a)(2)(B), Taxpayer's apportionment factor for its air transportation service is 22%. Taxpayer's apportionment factor is 18.25, computed as follows: 12% times ($600/$1600) plus 22% times ($1000/1600). See below for how apportionment factor was calculated.

	Col A	Col B	Col C	Col D	Col E
	Gross Receipts	Transportation Receipts	Apportion-ment Fraction	Weighting	IL Factor C times D
Transporting ground	$600	$600	12.00%	(600/1600)	4.50%
Transporting air	$1000	$1000	22.00%	(1000/1600)	13.75%
Non-transportation receipts	$100	$0	0.00%	0	0.00%
Sub Totals	$1700	$1600	~~	~~	18.25%

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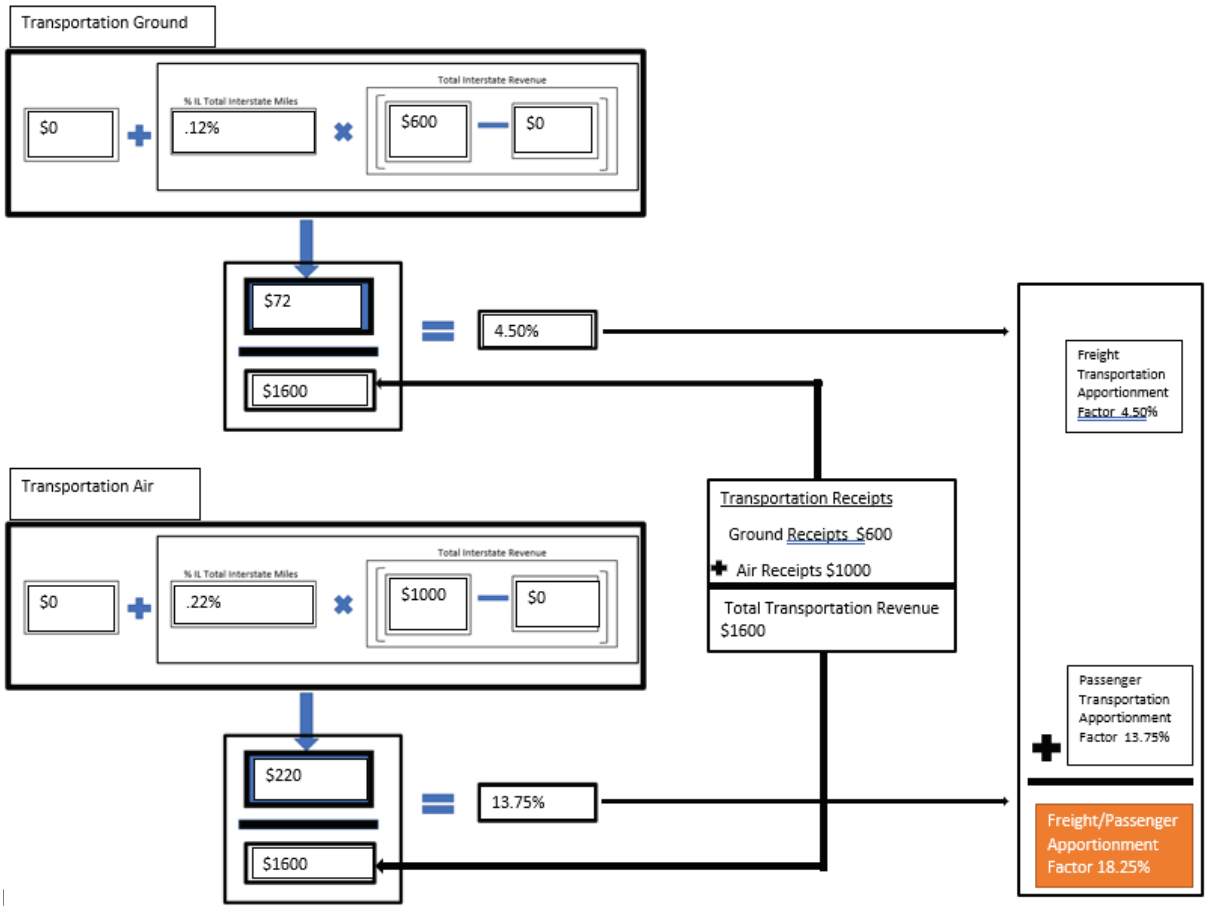

4. Transport by Water

Barging companies are liable for Illinois Income Tax when the barge travels in or through Illinois. Most barge companies are regulated interstate companies. The companies usually have maps, which reflect "route miles" traveled. These maps can provide a control from which to verify the state mileage information obtained from the company. Unless the taxpayer maintains specific records of miles or routes actually traveled by a vessel in a particular trip, the miles transported or traveled is the standard distance in miles between the points of pickup and delivery. Most barging companies operate on the Illinois or Mississippi Rivers, although a few do travel some of Illinois' smaller rivers. Distances may be rounded to the nearest mile.

a) Rivers Totally within Illinois

All miles on the Illinois River and any other river located within the boundaries of Illinois should be allocated to Illinois.

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(1) MISSISSIPPI RIVER

All NORTHBOUND miles traveled on the Upper Mississippi River from a point near Cairo, Illinois to a point near East Dubuque, Illinois (580.7 miles) are considered Illinois miles. REF: People ex. Rel Wangelin v City of St. Louis, 10 NE 2d 369, 367 Ill. 57 (1937). The western boundary of Illinois is considered to be in the middle of the Mississippi River. REF: The Enabling Act of April 18, 1818 created the state of Illinois and its boundaries. Northbound traffic moves along the east side of the river. Southbound traffic moves along the west side of the river. Therefore, all southbound miles are non-Illinois miles.

(2) OHIO RIVER

In the US Supreme Court decision, *Illinois v Kentucky, 500 U.S. 380 (1991)*, the Court found that the boundary line between the states of Illinois and Kentucky is the low-water mark of the northerly shore of the Ohio River AS IT EXISTED IN 1792. Prior to this decision, it was generally believed that the Illinois boundary was the low-water mark as it exists at any given time. The case was remanded to the states to determine the exact location of the "1792 line". In March of 1993 the Attorneys General of Illinois and Kentucky reached an official agreement, establishing the boundary between the two states. Under that agreement,

- The boundary will be set at the minimum of 100 feet from the Illinois shore of the Ohio River. At some points, the Illinois border will extend farther into the river.

- The low-water mark of the Ohio River will be determined by the "digitized" map created by the US Geological Survey. The boundary will be adjusted in Illinois's favor if the low-water mark is less than 100 feet from the Illinois shore.

- Kentucky will retain possession of several parcels of land that were islands in Kentucky territory at one time, but which have since become attached to the Illinois shore due to the changing shape of the river. Whether or not this case will have a significant impact on the taxation of transportation companies under the IITA is questionable.
    - At one point the decision states, "Vessels traveling the river usually follow a sailing line charted by the United States Army Corps of Engineers which, for most of the stretch in question, is either close to the center of the river or near the Kentucky shore. Illinois does not dispute that the sailing line, like most of the river, is within the boundary and jurisdiction of Kentucky."

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(3) LAKE MICHIGAN

The portion of Lake Michigan which falls within the borders of Illinois is determined based on the Enabling Act, which was passed by the US Congress on April 18, 1818. The Enabling Act provided for the creation of Illinois and its boundaries. Based on the provisions of that Act, to determine the portion of Lake Michigan which is in Illinois, one should:

- Draw a line straight east from the extreme northwest corner of Indiana to the center of Lake Michigan, then
- Draw a line north along the middle of Lake Michigan to north latitude forty-two degrees thirty minutes, then
- Draw a line west to the Illinois/Wisconsin border.

Case synopses of People ex. Rel Wangelin v City of St. Louis and Illinois v Kentucky can be found in Chapter 37.

5. Transport by Pipeline

Pipeline companies are in the business of providing transportation services. Distances may be rounded to the nearest mile.

There are generally two types of pipeline companies:

- **Natural gas** pipelines are considered utilities and are heavily regulated.
  - Whether a natural gas pipeline ships gas for third parties or buys gas at the well head and sells it later, it is allowed the same profit.
  - Typically, a natural gas pipeline will own the gas it transports.
    - In order to maintain pressure a pipeline must always be full. Therefore, a certain amount of gas, called linepack, is kept in the system.
    - In order to assure themselves that they have enough gas to maintain pressure, the gas companies usually take title to the gas at the shipping point.

- **Oil pipelines** are not considered utilities and are free to establish competitive rate structures (however, many US pipelines are subject to an antitrust decree from the 1920's limiting them to a percentage markup on their capital costs).
  - Oil and liquid hydrocarbon pipeline companies usually do not take title to the product being transported.
    - Regardless of whether the companies take title or not, they fundamentally remain pipelines.
    - The nature of their business activity remains unchanged; the transportation of oil or gas.

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The purpose of any apportionment formula is to apportion business income based on the amount of business income attributable to the state based on the level of business activity in the state as compared to the business activity everywhere.

- Since pipeline companies are capital intensive businesses with few employees, little property other than the pipeline itself and sales which are usually isolated at a few locations at the end of the pipeline, it was determined that the most accurate way to determine the amount of business activities in Illinois was through the use of the revenue mile formula.

- Some pipeline companies are also involved with the sale of the product being transported at retail when it reaches a delivery point.
  - If this activity is a significant part of the pipeline company's overall business activity, it is possible that this retailing portion of the company's activity should be apportioned by using the 3-factor formula of IITA § 304(a).

Note: Under the 80-20 test in IITA 1501(a)(27), the Outer Continental Shelf is in the United States. For taxable years ending on or after December 31, 2017, the phrase "United States", as used in this paragraph, means only the 50 states, the District of Columbia, and any area over which the United States has asserted jurisdiction or claimed exclusive rights with respect to the exploration for or exploitation of natural resources, but does not include any territory or possession of the United States. The pipeline between the shore and the OCS is in the US for apportionment purposes.

6. Transport by Air

Airlines may be transporting freight and/or passengers. The miles transported in a flight are the air distance in miles on the most common route between the airports. Distances may be rounded to the nearest mile or tens of miles.

a) Fly-over Miles

Flyover (or bridge) miles are those miles flown over a state in which the flight does not originate or terminate. The flight's only contact with the state is when it actually "flies over" in the air space above the state. These miles are not used in calculating the apportionment factor. Examples

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(a) An airline flies from New York to Los Angeles. It travels 200 miles within New York and 200 miles within California. Total miles traveled are 3,000. Fly-over miles are 2,600.
Apportionment IL 0
EV 3,000

(b) An airline flies from Chicago to Los Angeles. It travels 100 miles within Illinois and 200 miles within California. Total miles traveled are 2,000. Fly-over miles are1,700.
Apportionment IL 100
EV 2,000

(c) An airline flies from Los Angeles to Hong Kong. It travels 2 miles within California and 1 mile within Hong Kong. Total miles traveled are 10,003. Fly-over miles are 10,000.
Apportionment IL -0-
EV 10,003

Potential Court Cases/support used by taxpayer

In support of their position, airlines might refer to an amendment to the Federal Aviation Act of 1958, which was included in the Omnibus Budget Reconciliation Act of1990 PL.101-508. That amendment states:

> (f) Flight Takeoff or Landing Requirement of State Taxation No State [as such term is defined under subsection (d)(2)(E)] or political subdivision thereof shall levy or collect any tax on or with respect to any flight of a commercial aircraft or any activity or service on board such aircraft unless such aircraft takes off or lands in such State or political subdivision as part of such flight.

In *Northwest Airlines, Inc. and Republic Airlines, Inc. v. The Department of Revenue of Illinois*, No. 1-96-4267(1998), the Illinois Court of Appeals determined that “flyover miles” cannot be included in the numerator of the apportionment formula. The court said that there was “a total absence of any nexus” between such miles and the state. The Department had argued that the Illinois statute clearly implied that such miles were included in the transportation apportionment factor. The court replied that, since their inclusion would violate the commerce and due process clauses of the United States Constitution and make the statute unconstitutional, it assumed that the legislature did not intend any such implication.

The court discussed *GTE v. Allphin*, 68 III 2d 326(1977) an Illinois Supreme Court case involving shipments that were “drop shipped” out of state but were the products of contracts bargained for by Illinois producers. That case said that the state taxation regime was designed to ensure that 100% of a taxpayer’s income

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from interstate commerce should be reachable by one state or another and that there should be no "nowhere sales." The *Northwest* court acknowledged the principle but said that some connection with Illinois is still required. Flyover miles create no such connection.

B. **For taxable years ending prior to December 31, 2008**:

Business income of a transportation company shall be apportioned by multiplying that income by a fraction.

Numerator:
- Revenue miles of the person in this State

Denominator:
- Revenue miles of the person everywhere. (IITA Section 304(d)(1) and (2))

V. UNITARY BUSINESS GROUPS

A unitary determination is required for a commonly owned group of transportation companies. Refer to Chapter 23 for information on making a unitary determination. If it is determined that a group of different types of transportation companies are unitary, although their apportionment formulas are different, they can be unitary.

For taxable years ending on or after December 31, 2017, the noncombination rule is eliminated. A unitary business group may now include members that are required to use different apportionment formulas under IITA § 1501(a)(2)(A). The combined apportionment for taxpayers is governed by IAC § 100.3600.

Example: A shipping company, pipeline oil company and a trucking company can all be in the same unitary group. When computing the apportionment formula, the auditor will have to use the weighted average method described in IITA § 304(d)(1)(A), (B) and (2).

Transportation companies who conduct 80% or more of their business activities outside of the United States are excluded from being in a unitary business group.
- The 80/20 test is utilized to determine this percentage. It is the ratio of revenue miles in the United States as compared to revenue miles worldwide. REF: IITA § 1501(a)(27).

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VI. DEFINITIONS OF INDUSTRY TERMS

There are numerous terms that are commonly used by people involved in the transportation industry. Some examples follow:

BACK HAULING - A truck has delivered goods into Illinois and then picks up a load for someone else for the return trip home.

BAREBOAT CHARTER - An instrument used for vesting possession and control of a chartered vessel to the charterer. The owner of the vessel retains general ownership and right of reversion.

BOBTAIL - A tractor pulling nothing; Bobtail miles are considered empty miles for purposes of the apportionment formula.

BRIDGE MILES - See pass-over miles.

BROKER MILES - Miles run by another company on contract to the taxpayer.

CHARTER PARTY- Agreement between a ship owner and carrier, merchant, etc...for commercial lease of a ship or space on the ship for a period of time.

CONTRACT MILES - See broker miles.

DEADHEAD - Tractor pulling an empty trailer or barge not carrying a load. Deadhead miles are considered empty miles for purposes of the apportionment formula.

DEMISE - A transfer by lease for a fixed period of time.

DIRECT MILES - Miles hauled by the taxpayer.

FERC - Federal Energy Regulation Commission

FLEETING - Owned or leased sites on river banks where barges are tied off while waiting to be moved.

FLY-OVER MILES - See pass-over miles.

MANIFEST - The driver's legal authority for a given job includes information on routes, type and amount of freight, and pickup and delivery points.

PASS-BY MILES - Miles traveled by a barge that is passing by Illinois without stopping.

PASS-THROUGH MILES - Miles traveled through Illinois in which a truck, bus, etc. does not stop in the State.

PASS-OVER MILES - Miles traveled over Illinois by an airplane without stopping.

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REVENUE HIGHWAY MILE - Moving a vehicle 1 highway mile without taking the weight of the freight into account.

REVENUE PASSENGER MILE - 1 passenger times 1 mile for a fee.

TOWBOAT - The power unit used in the barging industry.

TRACTOR – The power unit used in the trucking industry.

TRIP LEASE - Hiring another hauler to perform a specific contract (sublet).

TRIP SHEET - The driver's log of a particular haul. This is the source of the mileage information.

TUGBOAT - See towboat

WILDCAT - A haul that is outside of a company's ICC authority, either with regard to type of freight or location of shipment. These miles are often shown as unallocated miles and are only included in the everywhere factor by the taxpayer

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FOREIGN SALES CORPORATIONS
Revised August, 2018

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I. PURPOSE

This chapter provides guidance for when the auditor may encounter an Interest Charge Domestic International Sales Corporation (IC- DISC) or Foreign Sales Corporation (FSC). Both IC-DISCs and FSCs were created to offer tax relief to companies earning foreign sales income from the exportation of US sourced goods. Further guidance for FSCs, Domestic International Sales Corporations (DISC), and the Extraterritorial Income exclusion (ETI) is provided in the Historical Extracts and Exhibits section.

Note: To aid referencing, hyperlinks are used within the body of the chapter to link to referenced exhibits and text.

II. REFERENCES

A. IITA

- § 207
- § 1501(a)(27)

B. IAC

- § 100.3100(b)
- § 100.3350(a), (b)
- § 100.3370(a)(2)(B)
- § 100.3380(e)

C. INTERNAL REVENUE CODE (IRC)

- IRC §243
- IRC § 921 – 927
- IRC § 992

III. BACKGROUND

Both Domestic International Sales Corporations (DISCs) and the Foreign Sales Corporations (FSCs) were created to provide domestic corporate entities the ability to export their products and receive favorable tax treatment on sales abroad.

DISCs were established by Congress in the Revenue Act of 1971 under IRC § 992. A DISC was not subject to federal income tax except under certain circumstances. The

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profits were not taxable to the DISC but were taxed when distributed or deemed distributed to the DISC's shareholders. Therefore, the DISC itself was generally not subject to Illinois income and replacement tax but the distributions were taxable.

The Tax Reform Act of 1984 created the Foreign Sales Corporation (FSC) by adding Sections 921 through 927 to the IRC. If a company had been a DISC on December 31, 1984, it had to liquidate and re-elect to become an FSC. Accumulated DISC income and assets were transferred tax free to shareholders who could claim the income in equal installments over a ten year period.

Therefore, for years ending after December 31, 1984, a corporation seeking a tax exemption for export income had to elect to be treated as a FSC. Small businesses could elect to be treated as a small FSC or an Interest-charge DISC (IC- DISC). However, the majority of the foreign sales entities created were regular FSCs.

IV. CURRENT TREATMENT: IC- DISC AND FSC

A foreign corporation must observe the same filing requirements as U.S. domestic corporations. For Illinois purposes all taxable income reported under IRC §§ 881 – 885 must be reported, and only domestic factor information is calculated in the “Everywhere” portion of the sales factor.

A. IC-DISC

The United States’ foreign trading partners challenged the legitimacy of the original DISC, FSC, and ETI exclusions. However the IC-DISC was added to the tax code in 1984, was not challenged, and is still ongoing. The IC-DISC became more lucrative to taxpayers as the ETI regimen was repealed and the election to become an FSC was discontinued. In 2003 tax rates were reduced for qualifying dividends under the Jobs and Growth Tax Relief Reconciliation Act and this reduction was extended in 2012 through the American Taxpayer Relief Act. As a result of these actions the tax benefits of an IC-DISC became more beneficial and there has been a gradual increase in the number of IC-DISCs.

To become an IC-DISC the exporting company or its shareholders create a domestic corporation and elect for this corporation to be treated as an IC-DISC by filing IRS Form 4876-A.

- shareholders of the corporation elect IC-DISC status

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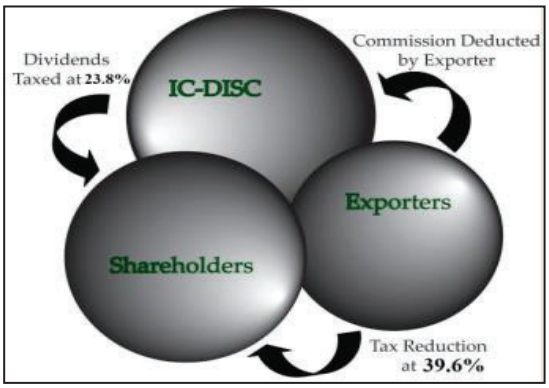
- exporting company pays the IC-DISC a commission based on export sales profits
- exporting company deducts the commission owed to the IC-DISC from its ordinary income
- IC-DISC pays no federal tax on the commission received from the exporting company (IC-DISCS are a special class of tax-exempt entity)
- shareholders who are individuals or trusts pay federal tax at a maximum 23.8 percent rate.



1. IC-DISC Treatment

An IC-DISC under IRC § 992 is not subject to the taxes imposed by IRC subtitle A (unless there is a transfer to avoid income tax under IRC § 1491). If an IC-DISC is not subject to tax and filing under IRC provisions it is also not required to file an Illinois return. The distributions from an IC-DISC fall under the IRC rules pertaining to dividends, dividend exclusions, and dividend-received deductions

An IC-DISC that, for federal purposes, has federal taxable income apportionable or allocable to Illinois is subject to Illinois tax rules applicable to all corporations. They would be taxed by Illinois to the extent that nonexempt foreign trade income, investment income, and carrying charges (taxable for federal purposes) are apportionable or allocable to Illinois. Corporate shareholders who derive income from Illinois should include actual and deemed distributions from an IC-DISC in their business income.

2. IC-DISC That is a Unitary Group Member

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If a corporation has elected to be a DISC under IRC § 992 as discussed above and is a member of a unitary business group, neither the portion of DISC income on which federal taxes are deferred for the year or the sales factor of the DISC will be included in the group's calculation of Illinois income tax liability. Corporate shareholders of a DISC should include only the actual and deemed distributions of the DISC which are taxable for federal purposes in the combined UBG apportionment.

DISCs with federal taxable income apportionable or allocable to Illinois are subject to Illinois tax rules. This FSC income is subject to tax by Illinois to the extent that income is subject to tax for federal purposes (nonexempt foreign trade income, investment income, and carrying charges) and apportionable or allocable to Illinois.

Corporate shareholders of a DISC should include in business income their actual and deemed distributions from the DISC, to the extent the distributions are federally taxed. To the extent that the DISC's activities are an integral part of the unitary business, the actual and deemed distributions should be included in the combined unitary business income. If a DISC meets the criteria for inclusion in the unitary business group, it must be listed under Step 1, Section A, of Illinois Schedule UB. However, computations for the DISC should not be required for Steps 2, 3, and 4 of Illinois Schedule UB. In conformity with the applicable provisions of the IRC, the other members of the unitary business group that are shareholders of the DISC should include such amounts in their respective federal taxable incomes (or equivalents) as are required to be included for federal income tax purposes.

Distributions from IC-DISCs are treated in accordance with the federal rules pertaining to dividends, dividend exclusions, and dividend-received deductions for Illinois purposes.

An IC-DISC is taxed by Illinois to the extent its nonexempt foreign trade income, investment income, and carrying charges (taxable for federal purposes) are allocable to Illinois.

B. EXISTING RULES FOR FSCs

No corporation may elect to be an FSC or a small FSC after September 30, 2000. FSCs which were in existence continuously on or before September 30, 2000 may continue to use the FSC rules for any transaction in the ordinary course of business before January 1, 2002; if such a transaction occurs after December 31, 2001 the transaction must be pursuant to a binding contract exception.

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If a binding contract was in effect on September 30, 2000 and has remained in effect the FSC rules still apply. A binding contract must be:

- between the FSC (or a person related to the FSC) and a person other than the related person, and
- a binding contract includes a purchase, renewal, or replacement option that is enforceable against a lessor or seller.

An FSC that was in existence on September 30, 2000, and at all times thereafter may elect to be treated as a domestic corporation if substantially all of its gross receipts are foreign trading gross receipts.

Ref: Instructions for Form 1120-FSC

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V. HISTORICAL EXTRACTS AND EXHIBITS

The DISC and ETI provisions and FSC transitional binding contract exclusions found in the IRC were repealed, along with the election to become an FSC. However, the auditor may encounter a need to reference FSC or ETI information. In those situations the following section is available for reference.

A. REPEAL OF FSC AND ETI

In 1998 the European Union (EU) contended that FSCs were prohibited export subsidies. FSCs could exempt a significant portion of their export income from U.S. tax. U.S. corporate shareholders also were allowed a 100% dividends-received deduction for dividends distributed from an FSC out of earnings attributable to certain foreign trade income. In Oct. 1999, the World Trade Organization (WTO) decided that the FSC provisions were prohibited export subsidies under the WTO Agreement on Subsidies and Countervailing Measures and the Agreement on Agriculture. Under a procedural agreement reached between the European Union and the United States, enactment of this legislation avoided an immediate confrontation with the EU by ensuring that the WTO must review the new law before any decision authorizing retaliation may be made.

The FSC Repeal and Extraterritorial Income Exclusion (ETI) Act of 2000 enacted the following:

- repealed the FSC provisions (IRC § 921 through 927) effective for transactions occurring after Sept. 30, 2000,
- established transition rules for FSCs,
- barred corporations from electing to be an FSC after Sept. 30, 2000,
- dormant FSCs (having no foreign trade income for five consecutive tax years beginning after Dec. 31, 2001) would cease to be treated as an FSC for any tax year beginning after that period; and
- provided that gross income does not include extraterritorial income (ETI) that is “qualifying” foreign trade income.

The transition rules established by the repeal did not apply to transactions that occurred in the ordinary course of business:

- prior to January 1, 2002, or
- after December 31, 2001 if a binding contract were in effect on September 30, 2000.

However, in 2002 the WTO held that the ETI regime was also a prohibited export subsidy. In 2004 the ETI provisions were repealed by Congress under the American Jobs Creation Act of 2004. This act ceased the ETI provisions but under a transition

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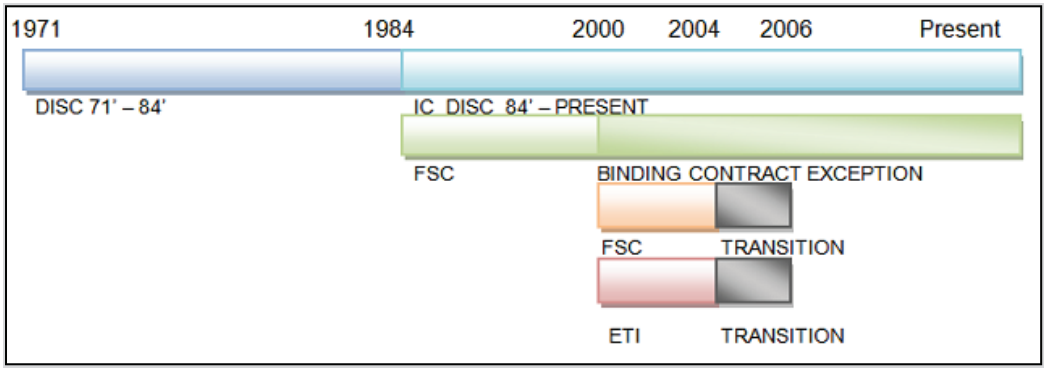
rule the qualifying foreign trade income would be phased out to 80% in 2005 and 60% in 2006.

In 2006 the WTO held that these ETI transition provisions, as well as the binding contract provisions (for binding contracts made after September 30, 2001) used in grandfathering FSC contracts, were prohibited export subsidies. The European Union was poised to begin implementing trade sanctions over these transition rules. As a result of EU's stance, the Tax Increase Prevention Act repealed both the FSC binding contract transition rule and the ETI binding contract transition rule.



B. EXTRATERRITORIAL INCOME EXCLUSION (ETI)

The ETI regime evolved as the FSC regime was repealed. The ETI was in effect for transactions entered into after September 30, 2000 and was an exclusion from gross income attributable to foreign trading gross receipts. Exclusion of qualifying foreign trade income would result in a reduction by the greater of:

- 1.2 percent of the foreign trading gross receipts derived from the transaction,
- 15 percent of the foreign trade income derived by the taxpayer from the transaction, or
- 30 percent of the foreign sale and leasing income.

1. Foreign Trading Gross Receipts (FTGR)

FTGR are gross receipts derived from certain activities in connection with qualifying foreign trade property involving economic activities outside the US. The gross receipts must be from:

- the sale or exchange of qualifying foreign trade property

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- the lease or rental of qualifying foreign trade property by a lessee outside of the US
- for services which are related to the above
- for engineering or architectural services for construction projects outside the US, or
- for the performance of managerial services for unrelated persons outside the US.

2. Qualifying Foreign Trade Property

Qualifying foreign trade property generally is property manufactured, produced, grown or extracted which is held for sale, use, consumption, lease or rental outside the US. The origin of the property can be within or without the US, however the foreign costs of production must be less than 50 percent of the fair market value.

3. Repeal of ETI

Prior to 2005, taxpayers were allowed to retain 100 percent of their ETI benefits. The percentage allowed for transactions entered into in 2005 decreased to 80 percent and 60 percent for 2006 transactions as a result of the repeal of the ETI exclusion.

The ETI binding contract transition rule was allowed for binding contracts which had been in effect on October 21, 2004, for transactions occurring in the ordinary course of business between the taxpayer and an unrelated person which were in effect on September 17, 2003 and at all times thereafter. However, the binding contract rule itself was ruled to be a trade violation and terminated May 18, 2006.

C. FSC SETTLEMENT OFFER

The Department had given inconsistent public statements regarding whether or not foreign apportionment factors of a foreign sales corporation should be included or excluded for the tax years ending between December 31, 1989 and prior to January 1, 1998. The Schedule UB instructions for the years 1990 through 1997 stated that foreign sales corporations must only use apportionment factors from the United States, excluding their foreign sales amounts. This position was in line with a letter

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ruling, IT 91-0199, which was revoked. IAC § 100.3380(e) became effective on May 25, 2001 and was in conflict with that letter ruling.

IAC § 100.3380(e) provides that foreign taxpayers whose foreign income is excluded from federal taxable income must use only apportionment factors related to domestic business income to apportion business income. If the taxpayer is part of a unitary group it could be included under IITA §1501(a)(27) if its domestic factors were 20% or more under the 80-20 test.

In consideration of the confusion caused by inconsistent public statements the Department put forward a settlement offer for the FSC issue for tax years beginning 1/1/90 through tax years beginning prior to 1/1/1998. For these years, the Department was willing to concede 70% of the FSC income and factors associated with the issue. For tax years beginning on or after 1/1/1998, FSCs were included in the unitary business group if they met the statutory tests.

1. Settlement Offer Revocation

FY Bulletin 2006-8 dated March 1, 2006 revoked the settlement offer for FSCs. The revocation bulletin may be reviewed on the IDOR web page and includes the following:

> Effective immediately, the department is revoking the settlement offer. The department is under no obligation to determine the Illinois Income Tax liability of any taxpayer for any tax year in accordance with that offer, unless the liability was computed in accordance with the offer prior to March 1, 2006.

D. PRE-REPEAL RULES FOR FSC

1. Foreign Trading Gross Receipts (FTGR)

An FSC is not taxed on its exempt foreign trade income. IRC § 923 defines exempt foreign trade income as "the gross income of a FSC from foreign trading gross receipts." The FSC generates FTGR in order to receive favorable tax treatment. The FSC will be considered to earn FTGR only if the foreign management and the foreign economic process requirements are met for each eligible transaction. The FSC must have FTGR to use the Administrative Pricing rules to calculate its profit that in turn will determine the amount of tax exempt foreign trade income.

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1. An FSC is treated as having Foreign Trading Gross Receipts (FTGR) only if it has met certain foreign management and foreign economic process requirements (see below).

2. Gross receipts comprising FTGR include gross receipts: REF: IRC § 924

    a. From the sale, exchange or other dispositions of export property;
    b. From the lease or rental of export property for use by the lessee outside the U.S.;
    c. For services related and subsidiary to above items; or
    d. For the performance of managerial services for an unrelated FSC, or DISC to advance the production of FTGR.

3. FTGR does not include receipts from a transaction if:

    a. The export property or services are for the ultimate use in the U.S.;
    b. Such transaction is accomplished by a subsidy granted by the U.S.;
    c. Such receipts are from another FSC that is a member of the same controlled group as the subject FSC; or
    d. The income is characterized as investment income or carrying charges.

REF: IRC §§ 924(f), 927(c), (d)

Carrying charges normally result in a situation where the U.S. supplier sells to a foreign customer and the customer doesn't pay charges within a specified time (normally 60 days). The supplier will charge the customer for deferring payment time.

If an FSC has the types of income described above, it will not be disqualified as an FSC. The income that does not qualify as FTGR will not receive favorable tax treatment (i.e. no part of this income will be exempt from U.S. taxation and therefore, Illinois taxation). This nonexempt income is calculated on Schedule F of the 1120FSC and carried onto Part II of Schedule B to be included in "Taxable Income" of the FSC.

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a) Export Property

Export property is defined as:

a. Property manufactured, produced, grown, or extracted in the U.S. by a person other than an FSC; or

b. Property held primarily for sale, lease or rental in the ordinary course of a trade or business by an FSC to an FSC or any other person for direct use, consumption or disposition outside the U.S.

The ultimate destination must be outside the U.S. If the sale is made to a U.S. customer, the sale must be tracked to verify its ultimate destination is outside the U.S. If the sale is made to a foreign customer, the IRS will not usually go behind this information to verify that product did not return to the U.S.

It is also important to note that, federally, this requirement will be considered met for leased property, if that property is located outside the United States more than 50% of the time. Transportation property (i.e. airplanes) is considered primarily "located outside the U.S." based on either more than 50% of miles traveled in use of the property are outside the U.S. or the property is located outside the U.S. more than 50% of the time. (REF: IRC Temporary Regulation §1.927(a)-1T(d)(4)(vi).)

Property must have less than 50% of its fair market value attributable to articles that were imported into the U.S. In other words, the property cannot have more than 50% of its parts manufactured in foreign countries.

Export property does not include:

a. Property leased or rented by an FSC for use by any member of a controlled group of corporations of which such FSC is a member,
b. Patents, inventions, models, designs, goodwill, trademarks, trade names, franchises, etc.,
c. Oil and gas,

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d. Prohibited property (declared such by the President of the United States), and
e. Property in short supply (declared such by the President of the United States).
REF: IRC § 927

b) Foreign Management Rules

An FSC (other than a small FSC) is treated as having FTGR for the tax year only if the management of the FSC during the tax year takes place outside the United States. These management requirements are as follows:

1) All meetings of the Board of Directors and meetings of the shareholders of the FSC must take place outside the U.S. The 1120-FSC instructions state all such meetings must also comply with the local laws of the foreign country or U.S. possession in which the FSC is created or organized. Therefore, local laws determine whether a meeting must be held, when and where, if at all, who must be present, quorum requirements, use of proxies, etc.

The wording of this requirement can be very misleading. The requirement is that "all" meetings must take place outside the U.S but it does not state that there must be a meeting during the year. Therefore, if local law does not require a meeting, the FSC is not in violation of the rules if it does not hold a meeting.

2) Cash, dividends, legal and accounting fees, salaries of officers, and salaries or fees of directors disbursed during the year must be disbursed out of the principal bank accounts of the FSC maintained outside the U.S. However, if no disbursements are made, this requirement has been met.

3) The principal bank account is maintained outside the U.S. at all times during the tax year. The FSC will have the bank account in the foreign country but it may only debit commission income to and credit commission expense from the account.

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c) Foreign Economic Process Rules

In addition to the foreign management requirements, certain economic processes must take place outside the US in order for an FSC (other than a small FSC) to have FTGR from any transactions. 26 CFR §1.924(d)-1 sets forth the rules for determining whether a sufficient amount of the economic processes of a transaction take place outside the United States. Generally, a transaction will qualify if the FSC satisfies two requirements:

1. Participation outside the US in the sales portion of the transaction, and
2. Satisfaction of either the 50% test or the 85% foreign direct cost test.

d) Participation Outside of US in Sales Portion of Transaction

This requirement detailed in IRC § 924(d)(1)(A) addresses the necessity of foreign involvement in a sales transaction for it to qualify as a FTGR. If the FSC participates outside the U.S. in any of the following sales activities relating to a transaction, the gross receipts from that transaction qualify as FTGR:

1. Solicitation (other than advertising);
2. Negotiation; and
3. Making a contract.

e) Solicitation

Solicitation is (other than advertising) any communication (including but not limited to telephone, telegraph, mail or in person) by the FSC to a specific, targeted customer or potential customer. The solicitation must promote to the customer the product or service that is the subject of the transaction; and it must take place during the 12-month period preceding the execution of a contract relating to the transaction.

f) Negotiation

Negotiation is any communication by the FSC to a customer or potential customer dealing with the terms of the transaction, including

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but not limited to price, credit terms, quantity, or time or the manner of delivery. Negotiation does not include the mere receipt of communication from a customer (such as an order) that includes terms of a sale.

g) Making of a Contract

This refers to performance by the FSC of any elements necessary to complete a sale, such as making or accepting an offer. Acceptance of an unsolicited bid or order is considered the making of a contract even if no solicitation or negotiation occurred with respect to the transaction. The written confirmation by the FSC to the customer of an oral or written agreement that confirms variable contract terms such as price, credit terms, quantity, or time or manner of delivery, or specifies (directly or by reference) additional contract terms, will be considered the making of a contract. A written confirmation is any confirmation in writing, including a telegram, telex or other similar written communication.

Generally, the sales activities described above are applied on a transaction-by-transaction basis. However, the FSC may make an annual election, on Schedule P of the 1120-FSC, to apply any of the sales activities on the basis of a group. The FSC can elect to group the activities, for example, by product line, customer or contract. The grouping rules allow qualification of the entire group even if only a percentage of the transactions within the group actually meet the test. REF: 26 CFR § 1.924(d)-1(c)(5)

The following is an example of how the FSC can meet the above requirements: REF: 26 CFR § 1.924(d)-1(c)(6)

> **Example**
> An FSC earns commissions on the sale of export property by its domestic related supplier to U.S. wholesalers for final sale to foreign customers. The related supplier receives an order from one of its U.S. wholesalers. The related supplier telephones the U.S. wholesaler to inform it of the new price and the probability of another price increase soon. The U.S. wholesaler orally agrees to the new price and the related supplier instructs the FSC to telex the wholesaler from its foreign office a confirmation

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that the product will be sold at the current new price. The written confirmation by the FSC of an oral agreement on a variable contract term constitutes the making of a contract and the requirement has been met with respect to the transaction relating to the product

The activities comprising these economic processes may be performed by the FSC or by any other person (related or unrelated) acting under contract as an agent for the FSC.

The requirements of any test contained in the economic process rules are minimal and, therefore, not hard to meet. The FSC can be an agent relationship.

Example
A domestic corporation creates an FSC under the rules and regulations of the IRC. The two corporations then execute an agreement/contract outlining the contractual relationship between the two. Next, because an FSC also has the ability to sub-contract, another agreement is then negotiated (normally) with the domestic parent. In effect, the domestic parent becomes the subagent of the FSC and does most of the work while the FSC does relatively nothing other than meet the minimal requirements necessary to maintain FSC status. The domestic parent is allowed to take a deduction for FSC commission expenses on its return and to exclude from taxable income any dividends or deemed dividends from the FSC thereby reducing its federal taxable income.

h) Satisfaction of 50% or 85% Test

To qualify as FTGR, foreign direct costs incurred by the FSC attributable to the transaction must satisfy either the 50% or 85% test.

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(1) 50% Test

The foreign direct costs incurred by the FSC attributable to the transaction must equal or exceed 50% of the total direct costs incurred by the FSC attributable to the transaction. Direct costs are those costs incident to and necessary for the performance of any of the following activities (see IRC§ 924(e)):

1. Advertising and sales promotion (IRC § 924(e)(1));

Direct costs of advertising include transmitting or distributing the advertising, but do not include the cost of preparations of the advertisement. Advertising to U.S. customers does not count.

The direct cost of sales promotions includes rental of space at trade shows, payments to organizers or other persons hired, rental of display equipment and decorations, costs of maintaining a showroom, cost of travel, lodging and food for direct sales people.

2. Processing of customer orders and arranging for delivery (IRC § 924(e)(2));

Processing of customer orders means notification by the FSC to the related supplier of the order and of the requirements for delivery.

“Arranging for delivery”’ means taking the necessary steps to have the export property delivered to the customer. Direct costs include salary of clerical personnel and cost of communication but not the actual shipping costs.

3. Transportation from the time of acquisition by the FSC to the delivery to the customer (IRC § 924(e)(3));

Transportation means moving or shipping the export property during the period when the FSC owns the property, or during the period after the commission relationship begins. Direct costs of transportation include shipping expenses, fees paid to

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freight forwarders, cost of freight insurance, and documentation fees.

4. Determination and transmittal of a final invoice or statement of account and receipt of payment (IRC § 924(e)(4)); and

This category refers to the assembly of either the invoice or statement and forwarding that document to the customer. The direct costs involved are office supplies, office equipment, clerical salaries, mail or other delivery service. To incur foreign costs, at least the final assembly of information and the mailing of the documents should be done from abroad.

5. Assumption of credit risk (IRC § 924(e)(5)).

Assumption of risk means bearing the risk of nonpayment for merchandise. The direct costs include debts that are uncollectable, cost of insurance that covers default and bankruptcy, cost of investigating credit, etc.

(2) 85% Test

Under this test, the foreign direct costs incurred by the FSC attributable to a transaction must equal or exceed 85% of the total direct costs incurred by FSC in relationship to 2 of the 5 categories listed above.

Direct costs are those costs that are incident to and necessary for the performance of any activity described in IRC § 924(e). Direct costs include the cost of materials consumed in the performance of the activity, and the cost of labor that can be identified or associated directly with the activity (but only to the extent of wages, salaries, fees for professional services and other amounts paid for personal services actually rendered, such as bonuses or compensation paid for services on the basis of a percentage of the profits.) Direct costs also include the allowable depreciation deduction for equipment or facilities (or the rental cost of its use) that can be specifically identified or

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associated with the activity, as well as the contract price of an activity performed on behalf of the FSC by a contractor.

The FSC shows its total foreign direct costs and total deductions on Schedule G of the 1120-FSC. It must also indicate on the FSC return the test (50% or 85%) used to meet the foreign direct costs requirement. If the 85% test was used, the FSC must also indicate the two activities in which the 85% foreign direct costs were incurred.

2. Transfer Price Rules

Once the FSC has determined its foreign trading gross receipts, the FSC must use the Transfer Pricing Rules to calculate the amount of federal taxable income that can be sheltered by the FSC.

For a "Buy-Sell FSC", the transfer pricing rules provide a floor or minimum price at which the FSC can be deemed to purchase property from its parent. For a "Commission FSC", the rules provide the ceiling or maximum commission that the FSC can be deemed to charge for its services.

The "related supplier" (normally the parent of the FSC) uses Schedule P of the 1120-FSC return to calculate the transfer price to charge the FSC or the commission to pay to the FSC under the administrative pricing rules.

These calculations may be made on a transaction-by-transaction basis, group of transactions basis or aggregate of transactions basis. If the taxpayer chooses the transaction-by-transaction method, a Schedule P must be done for each transaction. A Schedule P must also be done for each group of transactions or each aggregate of transactions.

There are two methods allowed to compute the FSC profit - the 23% of combined taxable income (CTI) method or the 1.83% of foreign trading gross receipts method. The taxpayer is allowed to determine which method is most advantageous. Once the commission is computed on Schedule P, the amount is then transferred to Schedule B.

Also included on Schedule P is the related supplier's (i.e. the parent's) "expenses allocable to foreign trading gross receipts." The parent must retain

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support for the amounts shown on Schedule P (since the IRS audits the parent's books but not necessarily the FSC's). This may be a good place to start when trying to understand what the parent/related supplier actually does for the FSC. However, these expenses could only represent CPA expenses of keeping the FSC books and records. If so, you will need to ask the taxpayer specific questions concerning how and what type of work is done for the FSC by the parent/related supplier.

3. Summary of Federal Taxation

When an FSC earns Foreign Trading Gross Receipts, 16/23 or 69.565% is EXEMPT from federal and Illinois tax, and 7/23 or 30.5% of federal taxable income is taxed at regular rates.

4. Illinois Law and Rulings in Relation to FSCs

Illinois law contains no special provisions for DISCs or FSCs. They are covered under the same statutes as any other corporation. However, there are two sections of the IITA which provide general guidance, as well as the guidance provided in the instructions for the IL-1120 and Schedule UB.

IITA § 102 provides that the IITA will follow the United States Internal Revenue Code unless expressly provided otherwise in the IITA. The Act will have the same meaning as the comparable context of the IRC's provisions of statutes which are in effect for the taxable year.

IITA § 1501(a)(4) defines a corporation to include associations, joint-stock companies, insurance companies and cooperatives. This section of the IITA also provides that any entity meeting the definition of a corporation, including a limited liability company, will be treated as a corporation if it is so classified for federal income tax purposes.

A foreign corporation must observe the same filing requirements as U.S. domestic corporations. If taxable income is being reported for federal purposes under IRC Sections 881 through 885 and the taxpayer has Illinois nexus it should file form IL-1120. Only the domestic factor information regarding sales information in the "everywhere" denominator should be used when apportioning business income to Illinois.

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However, an FSC under IRC § 992, is not subject to the taxes imposed by IRC Subtitle A (except for taxes imposed due on a transfer under IRC § 1491). If the DISC or FSC is not required to file federally and is not subject to taxes, it is also not required to file Form IL-1120.

In the scenario where a DISC or FSC is also a member of a unitary business group, only the actual and deemed distributions taxable to the DISC's or FSC's shareholders should be accounted for in determining Illinois income tax liability.

5. Illinois Audit Issues

The following sections contain procedures for including FSCs in an Illinois unitary group. Also, some of the major issues encountered by the auditor are addressed.

In order for the FSC to generate foreign trading gross receipts, it must have a foreign presence. The FSC must satisfy certain federal requirements to prove that it has a foreign presence. The federal rules were deliberately designed so that a minimum amount of foreign activity by the FSC will be treated as if all of the activity was performed in the foreign country thus allowing the FSC to satisfy the foreign presence requirements. These rules are almost artificially applied to assist the FSC in claiming a foreign presence. The following examples illustrate:

a) Foreign Sales Test

If the FSC or its agent communicates, in any way, with the targeted customer during 1-year immediately preceding finalization of a specific transaction, then that sale has taken place outside of the US even if the majority of the transaction took place in the US. REF: IRC § 924(d)(1)(A)

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b) Direct Cost Test

- If the advertising material is mailed from the foreign location then all of the cost of producing the mailing, even if incurred in the US, is treated as cost incurred by FSC outside the US; and

- When the FSC pays the cost of shipping, whether included in the sales price or separately stated, the FSC is deemed to have engaged in the transportation activity. The location of the transportation activity is the area over which the property is transported. The portion of the direct cost is the portion of mileage outside US.

In other words, if the related supplier delivers the goods to the FSC at the US port, then the portion of the transportation cost from that port to the foreign country is all direct foreign costs.

- The cost of packaging, crating and other pre-transportation cost usually incurred by the related parent is not included in the "Direct Cost Test."

When auditing an FSC, there are three questions that arise in connection with the FSC as with any corporation.

1. Is the FSC unitary with the parent?
2. Should the FSC be included in the unitary group or excluded because of the 80/20 rule?
3. What is the amount of income/loss, modifications and factors to be included in the unitary return?
   REF: IRC § 924(d)(1)(B);

6. Unitary Determination

FSCs are subject to unitary treatment if they meet the requirements. They should be in the group if they are related through common ownership with other taxpayers whose business activities are integrated with, dependent upon and contribute to each other. The FSC cannot be included in a unitary business group if 80% or more of its business activities are conducted outside the United States. (See Schedule UB - Combined Apportionment for Unitary Business Group and the IL-1120 instructions.)

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The current IL-1120 and Schedule UB instructions reflect the correct position as confirmed in Shaklee Corp. v. Illinois Department of Revenue (1998) – 298 Ill App 3d 1165, 738 NE2d 236.

As a result of the Shaklee decision, the 80/20 test is a rule of exclusion rather than inclusion. If a three-factor FSC has no property or payroll, it would fail to meet the 80/20 test for exclusion. In other words, the FSC must have 80% or more of its property and payroll outside the U.S. to be excluded from the unitary group. Otherwise, the FSC could be included in the group if the other unitary criteria are met.

The criteria for determining whether an FSC's operations are unitary are no different from any other corporation. Therefore, the auditor should follow the normal procedures in gathering the unitary information. However, some of the information regarding ownership, intercompany transactions, etc., can quickly be gathered by reviewing the Form 1120-FSC return.

In the majority of cases, it will be fairly simple and easy to establish a unitary relationship of the FSC with the parent company. A majority of the taxpayers will not resist the unitary determination. The points to remember are:

1. An FSC will normally be a wholly-owned subsidiary of the parent.

2. The FSC only exists as a conduit for the parent's foreign sales. It is totally dependent upon the business activities of the parent with intercompany sales, commission, management charges and integration with the parent.

3. The directors and the officers of the FSC, except for the non-resident director, will also be the directors and/or officers of the parent.

However, inclusion of the FSC in the unitary group will be a controversial issue. The taxpayer will argue that the FSC may be unitary but cannot be included in the unitary group because its operations are overseas. Since the FSC maintains an office overseas and has a non-resident director as required by the IRC, all payroll and rent expense are in the country of incorporation. The taxpayer will cite the 80/20 rule and IITA § 1501(a)(27), which prohibits the Department from including the 80/20 companies in the unitary group.

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Refer to Chapter 23 - Unitary Determination for more information.

7. Audit Procedures

The auditor will have to determine and document the following steps:

1. Determine whether or not the FSC is unitary with the parent;
2. Perform the 80/20 test on the FSC. Determine the property and payroll amounts and allocate those amounts to the foreign and US operations of the FSC; and
3. Identify the amount of FSC income to be included in unitary income.

To make these determinations, the auditor will need to ask the taxpayer a number of questions and review certain records and agreements. The last exhibit of this section is comprised of sample questions to aid the auditor on how to proceed.

In many cases, the FSC does not have property or payroll. All activities relating to an FSC, whether a "commission" or "buy sell", are performed by the parent company and/or a related subsidiary which in most cases is in the US. The Auditor should review and pay close attention to the "Commission" and "Related Supplier FSC Sub-agency agreements." These agreements will document the parent's (and/or related subsidiary) and FSC's relationship. These agreements will also detail the functions performed as an agent for the FSC by the parent or related subsidiary.

Another method to obtain information about the parent's activities in conjunction with the FSC is to follow a foreign sale through the entire process from the receipt of the order through the actual shipment of the product from the parent's warehouse. This procedure will clearly identify the parent's equipment being used and personnel involved in the activities undertaken on behalf of the FSC.

8. 80/20 Test

The Auditor must perform the 80/20 test to determine if the FSC has 80% or more of its total business activity outside the United States. The 80/20 test is

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the same test used to exclude from the unitary group members with 80% or more of their business activity performed outside the United States. Refer to the Audit Manual chapter 23 for 80/20 test information and procedures. REF: IAC § 100.9700(c)(1) and (2)(B) and IITA § 1501(a)(27).

9. Property Factor

In determining the property factor for the 80/20 test, the numerator will consist of property owned or rented in the United States and the denominator will be property owned or rented everywhere (worldwide).

In computing the property fraction, only property which is used, available for use or capable of being used should be included. Property used in the production of nonbusiness income, construction in progress or property that is permanently withdrawn from use should not be included. REF: IAC § 100.3350(a) and (b).

In applying the 80/20 test to the FSC, it must first be determined if the FSC actually owns or rents any property in the foreign country or the United States. This can be determined by reviewing the balance sheet of the FSC return. Small items may be expensed and not be listed on the balance sheet. Therefore, a review of the M-1 schedule or other deductions should be conducted to detect the items that should be included with property, which have been expensed. Occasionally, rent is included in other items such as management fees.

If the taxpayer claims rent expense, the Auditor should verify that the FSC is the actual lessee of the property. This can be accomplished by requesting and reviewing the lease. If the agent of the FSC actually rented the property, then that rent cannot be included in the property factor.

If facilities such as office or storage space, computers, desks, etc. of another company, foreign or domestic, are being used at little or no cost, we can attribute a fair market rental rate to this property. This amount can be included in the denominator of the property factor and in the numerator if the property is located in the United States.

The Department has the statutory authority to attribute property owned by others and used by the taxpayer at no charge or rented for a nominal rate to the taxpayer under IAC 100.3380(a)(2). A fair market value rental rate can be calculated for any property used in relation to the FSC's operations such as

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preparation of FSC invoices and statements, storage and safekeeping of FSC's records, tax return preparation, etc.

Example

The auditor determines that the parent's or related subsidiary's employees are performing the record keeping functions and preparing all of the tax returns for the FSC. According to the instructions for the 1120-FSC, the time required to prepare the return and perform the related record keeping functions is 146 hours. A fair market value rental rate of the equipment used in that function could be determined based on the time required to perform those duties for the FSC. The rental rate of that property such as desks, computers, calculators, etc. can be attributed to the property factor of the FSC.

Many other functions performed by the parent for the FSC should be examined such as shipping arrangements, sales activities, invoice preparation, billing activities, etc. to discover other items of property being used on behalf of the FSC. The responses to the questionnaire will provide leads to other areas for further examination.

For further information, please refer to the Property Factor section of Audit Manual Chapter 27.

10. Payroll Factor

The payroll factor for the 80/20 test will include all compensation paid by the FSC during the taxable year. The numbers to include in the payroll factor can be obtained from the salaries and wages deduction line on Schedule G of the FSC return. Also, any amounts listed on the cost of labor line of Schedule A must be investigated to determine if the cost was incurred by the FSC, the parent company or the agent for the FSC. If the FSC has deducted or expensed any salaries and wages, the auditor must verify that the individuals earning those "salaries and wages" are truly employees of the FSC as defined in IAC § 100.3100(b). If the taxpayer asserts that a foreign director or agent is an employee, it must be determined if they meet the definition of an employee. In order to be an employee, the individual performing services must have a legal relationship with the entity for which the services are being performed.

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If the auditor determines that there are employees of the parent performing functions on behalf of the FSC in the United States, IITA § 404 authorizes the Department to reallocate items of income or apportionment reflected on one company's records that in fact belong to another company. This section can be used to allocate to the FSC payroll of employees of the parent or other subsidiaries who perform functions on behalf of the FSC. However, the employees providing these services may be from a foreign subsidiary. Therefore, if the auditor is going to reallocate payroll under IITA § 404, all payroll of employees performing functions for the FSC will have to be reallocated even if it supports the taxpayer's contention that the FSC is an 80/20 company.

Example
The US parent sets up a "commission" FSC to increase foreign exports and receives favorable tax treatment on those sales. The parent has two salesmen on their payroll whose sole responsibility is to sell the parent's product overseas. The FSC receives a commission on the sales made by these salesmen. The auditor should reallocate the payroll of these salesmen to the payroll factor of the FSC using a Section 404 adjustment.

For further information, please refer to the Payroll Factor section of Audit Manual Chapter 27.

11. Income and Factors

Once the determination has been made that the FSC should be included in the unitary group, the remaining portion of the audit will be completed following the same procedures as any other unitary audit. Detailed procedures for verifying the income and factors are contained in Chapter 27.

12. FSC Income

The FSC will have income from foreign trade of which 65% is exempt for federal and Illinois purposes. Also, there will be nonexempt foreign trade income that includes 50% of the receipts from the sale, exchange or other disposition of military property or services, international boycott income, illegal bribes and other payments, etc. The FSC can have taxable non-foreign income such as interest, dividends, carrying charges, royalties, etc. All of

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these items are included on Schedule B, Line 20 of the 1120-FSC return, which is the taxable income or loss of the FSC.

The FSC income to be included in the unitary return will be obtained from that line with the net operating loss deduction on line 19a added back.

A net operating loss of a FSC will be carried in the manner as any other corporation following IITA § 207 for years ending on or after 12/31/1986. For years prior to 12/31/1986, IRC § 172 applied.

13. FSC Factors

The factor computations for the FSC will follow the same procedures as for any other member of a unitary group. All factors, domestic and worldwide, should be included in the apportionment formula. This is a change in the Department's position. However, in most cases, the FSC will not have nexus with Illinois unless the parent or related subsidiary has nexus in Illinois. Also in most cases, the commission FSC's factors will be eliminated as intercompany transactions. If this is the case, then the only purpose of the factors is to make the 80/20 determination.

A ''Buy-Sell" FSC will have to be examined more in depth. The same guidelines for attributing property and allocating payroll to the FSC as described in the Section on the 80/20 test should be used for the property and payroll factor determination. The only exception is that we are establishing Illinois and everywhere factors. Also, property and payroll factor rules as detailed in Chapter 27 are to be followed. In calculating the sales factor of a "Buy/Sell" FSC, 100% of all sales will be included in the factor. However, the sales from the parent and related subsidiary to the FSC must be eliminated from the denominator. If the "Buy/Sell" FSC has nexus in Illinois, then rules regarding throwbacks will need to be followed also.

14. Small FSC

IRC § 922(b) defines a small FSC as a corporation that has elected to be a small FSC and kept the election in effect for the tax year.

- It cannot be a member of a controlled group that includes an FSC as a member unless that FSC is also a small FSC.
- A small FSC is exempt from the foreign management and foreign economic process requirements described in the above sections.

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- Any (FTGR) receipts of a small FSC that exceed $5 million are not considered in determining its exempt foreign trade income
  - The $5 million limit may be further reduced if the small FSC has a short tax year, or the small FSC is a member of a controlled group which contains other small FSCs.

.15. Investigating A Foreign Sales Corporation

The following are areas to research during an audit of an FSC's operations. Auditors may adapt these areas into a question format for their particular audit. To avoid the possibility of follow-up questions, the taxpayer should be instructed to avoid “yes/no” answers, be as specific as they can be, and provide information and/or documents regarding the Foreign Sales Corporation:

1. "Commission Agreement"

2. "Related Supplier-FSC Sub-agency Agreement”

3. Names of Directors and officers.

4. List specific duties performed by these individuals in regard to FSC's operations, or foreign sales of the parent company through the FSC.

5. Indicate the location of the offices from which these duties are performed.

6. Names of individuals who perform the following functions in connection with the sales related to FSC's business. Please also indicate, in each case, the place from where these services are rendered:

   a. Solicitation of prospective customers.

   b. Finalizing and signing the sales contract.

   c. Credit check and approval.

   d. Preparation of sales invoice.

   e. Preparation of shipping documents.

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f. Preparing, packing, carting & shipping products to customers.

g. Preparation of customers' statements.

h. Maintenance of receivables.

i. Preparation of Form 1120-FSC, and accumulation of necessary data for its preparation ("Schedule P" and "Schedule G").

7. Please estimate the time individual(s) spend performing the above functions. Also estimate the footage or time that any assets (e.g., office space, warehouse space, computer equipment, warehouse & transportation equipment) are utilized in performing the above functions. Please understand that these estimates will be used to attribute property values to the above functions.

8. Name of the individual who is responsible for overseeing and monitoring foreign sales.

9. Please identify the FSC related expenses on the parent company's federal Form-1120 which are charged back to the FSC.

10. Details of expenses shown on Schedule P and Schedule G of Form 1120-FSC.

11. Please provide copies of bank statements for ALL accounts maintained by the FSC, either in the US or overseas.

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LOSSES & DISCHARGE OF INDEBTEDNESS

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I. PURPOSE

When conducting an audit on a taxpayer with losses, it is important to determine what types of losses are utilized on the return to ensure the appropriate rules are followed.

II. REFERENCE RESOURCES

A. Illinois Income Tax Act

IITA § 203(b)(2)(B), (D) and (E)
IITA § 203(e)
IITA § 203(g)
IITA § 207
IITA § 301(c)
IITA § 405
IITA § 502(e)
IITA § 506(b)
IITA § 905
IITA § 911
IITA § 1501(a)(27)

B. Illinois Regulations

86 IAC § 100.2050
86 IAC § 100.2200
86 IAC § 100.2210
86 IAC § 100.2220
86 IAC § 100.2230
86 IAC § 100.2240
86 IAC § 100.2250
86 IAC § 100.2300
86 IAC § 100.2310
86 IAC § 100.2320
86 IAC § 100.2330
86 IAC § 100.2340
86 IAC § 100.2350
86 IAC § 100.2410
86 IAC § 100.4500

III. GENERAL INFORMATION

A net operating loss (NOL) occurs when expenses exceed income. Illinois has progressed from having no law governing treatment of net operating losses, to allowing federal losses (FNOL's), to passing legislation that creates Illinois net losses (INL's). Included for discussion

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will be the election to forgo Illinois Net Loss (INL) carrybacks, carrying losses in unagreed audits, IITA §§ 905(n) and 911(h), how and when losses are to be applied, and discharge of indebtedness.

The three broad categories of losses are:

- Illinois Net Losses (INL)
- Federal Capital Losses
- Federal Net Operating Losses (FNOL)

An audit may contain all three types of losses. Illinois Net Loss is recognized for tax years ended on or after 12/31/1986. These losses result after applying Illinois modifications and apportionment percentage to federal taxable income/(loss). Capital losses have their own carryover and allocation issues that potentially arise in all years. Federal Net Operating Loss, will be addressed in the historical extracts section at the end of this chapter.

The following section addresses the general and special rules for carryback and carry forward periods, the election to forego the carry back period, and special limitations period for filing claims for INL's. Later sections will address the actual computation of losses.

IV. ILLINOIS NET LOSSES

An INL is the amount of loss incurred after applying the Illinois addition and subtraction modifications and then the allocation and apportionment provisions of the IITA. REF: 86 IAC § 100.2300(b)(1). The INL is reflected either as a base loss for 100% Illinois filers or as base loss allocable to Illinois. Illinois net losses are discussed in IITA § 207 and have been part of the Act since 1986. Losses are allowed to be carried to other years to offset income with few exceptions. Prior to 2003, losses could be carried back to certain years preceding the loss year. Any remaining loss was then carried forward to years subsequent to the loss year. The following chart outlines the changes to carry periods over the years.

Y/E Beginning Date	Ending Date	Carry Back	Carry Forward	Based on
12/31/1986	08/05/1997	3 Years	15 Years	IRC § 172
08/06/1997	12/30/1999	2 Years	20 Years	IRC § 172
12/31/1999	12/30/2003	2 Years	20 Years	IITA § 207(a)(2)
12/31/2003	And after	~No~	12 Years	IITA § 207(a)(3)

Note that, in determining the taxable years to which an Illinois net loss deduction (INLD) may be carried, taxable years ending on or after January 1, 2011, and prior to December 31, 2012, when no Illinois net loss deductions were allowed are not counted, whether or not the taxpayer had income in that year. Also, taxable years ending after December 31, 2012 and prior to December 31, 2014, are not counted if the taxpayer would have been allowed

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an Illinois net loss deduction in excess of $100,000 if not for the cap on deductions in those years.

A. Loss Application

Losses are to be applied according to IITA § 207(a-5)(B) by expiration date, not based on first-in first-out.

IITA § 207(a-5)(B) applies to each loss year, not a group of loss years. Since the Act does not specifically state that the taxpayer must use the loss year(s) in order they were incurred, it is allowable to use the losses that expire earliest first. The Act says the "loss shall be carried to the earliest taxable year to which such loss may be carried." So even though there is loss available from 2002, if loss is available from 2003, the 2003 loss may be used first. The instructions to the 2006 and forward Schedule NLD and 2005 and forward Schedule UB/NLD state, "use the loss that expires first".

This can potentially affect tax years ending 12/31/2003 through 12/31/2010 because from 2003 forward, losses can only be carried 12 years, whereas, losses from tax years 1997-2002 expire either after or at the same time as the 2003-2010 losses. Refer to charts below for calendar year filers' overlap periods.

Tax years involved:

TAX YEARS WITH 20 YEAR CARRY FORWARD PROVISION	
TYE	NLD EXP
12/31/1997	12/31/2018
12/31/1998	12/31/2019
12/31/1999	12/31/2020
12/31/2000	12/31/2021
12/31/2001	12/31/2022
12/31/2002	12/31/2023

TAX YEARS WITH 12 YEAR CARRY FORWARD PROVISION	
TYE	NLD EXP
12/31/2003	12/31/2016
12/31/2004	12/31/2017
12/31/2005	12/31/2018
12/31/2006	12/31/2019
12/31/2007	12/31/2020
12/31/2008	12/31/2021
12/31/2009	12/31/2022
12/31/2010	12/31/2023

Note: The expiration dates are extended by one year based on TYE 12/2011 not being counted as a carry year. For taxpayers reporting losses greater than $100,000 in calendar years 2012 and 2013, the expiration dates may be further extended by those years not counting for carry forward provisions as explained above.

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As illustrated if a taxpayer has a loss to carry from 1997 and another loss from 2003, the 2003 loss may be applied first as it would expire prior to the 1997 loss. GenTax does not automatically process losses according to this procedure; careful documentation is required for the NLD schedule to be adjusted accordingly.

B. Election To Forgo Carryback Period

A taxpayer may elect to forgo the carryback period for INLs incurred in tax years ended on or after December 31, 1986 and before December 31, 2003. For tax years ending December 31, 2003 and after, the carryback provision is eliminated from the IITA. The election to forgo the carryback period for Illinois losses is independent from the federal election. It must be made by the due date of the loss year return, including extensions of time, or, if the original return reports positive income, on the first amended return on which a loss is reported. Once the election is made, it is irrevocable for that tax year.

1. September 27, 1996 Through December 30, 2003

Carrybacks were mandatory unless an election was timely made to forgo a carryback. For loss years ending on or after September 27, 1996 and through December 30, 2003, the Department promulgated 86 IAC § 100.2330(c) to explain the election procedure. The election is made on the original loss year return by checking a box indicating the taxpayer wishes to forgo the carryback period. The election must be filed no later than the extended due date of the original return. If the box is not checked on the original return by the extended due date, the election to forgo the carryback period cannot be made at a later date. Without a timely election, under 86 IAC § 100.2330(a) & (d) the loss must be carried back before any remaining amounts can go forward.

The only exception to this rule would be for a federal or state audit change eliminating Illinois income, and creating an INL for the year. For a federal audit change, the taxpayer is entitled to make an election to relinquish the carry back period for the newly created INL on an amended return. The election in this case must be filed within 120 days from the federal finalization date. For an Illinois audit change creating a loss, the taxpayer may make the election for the newly created loss at the close of the audit. (Ref: 86 IAC § 100.2330(c)(3)) If the auditor is creating an INL, then the auditor should get a signed commitment from the taxpayer before completion of the audit that they are only going to carry the loss forward.

NOTE: There was a box on the IL-1120-X for tax years through 2004 where the taxpayer could make the election to forgo the carryback. Starting with the 2005 calendar year, the IL-1120-X is different for each year and a note at the top of the form tells the taxpayer to use the appropriate form for the year. If an amended return is filed for a tax year that creates a net loss which may be carried back, it

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must be an IL-1120-X from 2004 or prior, when the forms were not year-specific and had the box to elect to carry forward only.

If the taxpayer fails to check the box, and a subsequent federal change or audit causes it to have income in a carryback year, it must carry the loss back to offset that income.

86 IAC § 100.2330(a) also states that special federal rules concerning the years to which a loss may be carried apply to certain types of corporations (such as regulated transportation companies). These special rules will also be followed for INLs incurred in tax years ending prior to 12/31/99, because, for losses incurred in those years, IITA § 207 provided that INLs could be carried over for the same period as allowed by IRC § 172.

2. Prior to 1996

Prior to the 1996 tax forms there was no box on the IL-1120 to make the election to forgo the carryback. There were no instructions concerning the election prior to 1994. For these years implicit elections were allowed in one of two ways:

a. A statement attached to the loss year return stating the taxpayer's intention to forgo the carryback period; or,
b. The taxpayer could file the subsequent year's income tax return and reflect an Illinois NLD on the return before filing an amended return carrying the loss back.

However, in *Elgin Sweeping v IDOR,* (2007), the Cook County Circuit Court agreed in part with a 2006 administrative ruling that determined, "…neither federal nor state law recognize the concept of an 'implicit election' to forgo a carryback." Therefore, if no statement is attached to the original return specifically indicating the election to forego carryback, losses are required to be carried back first and then forward.

If the increase in income in the carryback year is due to a federal change that became final on or after August 13, 1999, the limitations period for any year to which a loss was carried is reopened to the extent that the carryover to that year is changed by increasing the amount of loss used in the federal change year. For other changes, if the statute of limitations for any of the carryforward years is closed, the duty of consistency or equitable recoupment doctrines should allow the Department to offset any refund (or increase any deficiency) by the increase in tax for the closed year that would result from proper computation of the carryover.

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C. Special Limitation Period For Illinois Net Loss

IITA §911(g) was added by PA 84-1042 and specifies a special period of limitation for filing claims for refund resulting from the carryback of Illinois net losses incurred December 31, 1986 or after. For these loss carrybacks, the limitation is 3 years after the time prescribed by law for filing the return (including extensions) FOR THE YEAR IN WHICH THE LOSS OCCURS. In addition, if Form IL-872 is signed extending the statute of limitation on the loss year, then this date plus six months is also the limitation date for the taxpayer to file a claim for refund resulting from the loss carryback.

IITA §911(g) also states that the limitations set on the amount of refund allowable under IITA §911(d) will not apply in these instances. This means that the amount of the refund allowable under IITA §911(g) will not be limited to the amount of tax paid in the 3-year (plus period for extension of time to file return) or 1-year period immediately preceding the filing of the return.

IITA §911(g) applies to Illinois losses incurred December 31, 1986 and after only - it DOES NOT APPLY TO FEDERAL LOSSES INCURRED PRIOR TO DECEMBER 31, 1986.

Another special period to be aware of is in regard to reported federal RAR changes. IITA § 905, Limitations on Notices of Deficiency, was amended by Public Act 91-541 for notices of deficiency relating to reported federal changes, and the carry years for INLs and Article 2 credits which are impacted by the RAR change. Prior to the change, a Notice of Deficiency may be issued at any time within 2 years from the date the taxpayer notifies the Department of the RAR change on an IL-1120-X. However, nothing was mentioned about the flow-through impact of the RAR on the carry years, so this provision created a new statute of limitations only for the loss year itself. Starting on or after August 13, 1999, if the RAR change is reported, PA 91-541 allows the two-year statute to be applicable to both the RAR year <u>and</u> any year to which the loss or Article 2 credits are carried. This is true even if the RAR impact on the carry year is not reported on an IL-1120-X for the carry year. Also, if no federal change return is filed to report a change that reduces an Illinois loss incurred in a year or that increases the amount of INL carryover that is used in the year, there is no limitations period for issuing a Notice of Deficiency for any year to which the loss was carried to reflect the federal changes to the amount available to deduct in that year. However, the amount of any proposed assessment in the Notice shall be limited to the amount of deficiency resulting from the re-computation based on the RAR change. If the regular statute of limitations has expired, an auditor may obtain a waiver within the two-year period to extend the statute of limitations for RAR purposes only. A timely waiver must be obtained on both the RAR years and <u>all</u> the applicable carry years.

If the RAR change year is unreported, the Department may issue a Notice of Deficiency at any time for the RAR year and the INL and Article 2 Credit carry year(s).

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In some circumstances, a taxpayer may not have been an Illinois filer in the year in which a post-12/30/1986 federal NOL was incurred. If the taxpayer was not an Illinois filer, there would be an apportionment factor of zero. No Illinois net loss could have been incurred. Therefore, in this case, no net operating loss carryforward will be allowed in subsequent years in which taxpayer becomes an Illinois filer. If the taxpayer actually incurred an INL in a year for which no return was filed, it may file the return at any time in order to allow a carryover of that loss to an otherwise open year, except to the extent the limitations on refunds in IITA § 911(h) apply.

D. Illinois Net Loss Deduction

When an INL is carried to another year and offset against the income for that year it is called an Illinois Net Loss Deduction (INLD). The INLD will offset base income for 100% Illinois filers or base income allocable to Illinois for apportioning filers. The following example reflects an INLD.

EXAMPLE:

IL-1120	12/31/2015
Base Income Allocable to Illinois	1,000
Illinois NLD	(500)
Net Income after NLD	500
Standard Exemption	500
Net Income	-0-

This example reflects the carryforward of an INL. The 500 INLD offsets taxpayer's base income allocable to Illinois which is an amount PRIOR to the application of any standard exemption.

E. Illinois NLD - IT and RT Amounts

86 IAC § 100.2050(b) states that the INLD for income tax and replacement tax purposes will be identical amounts.

For years ending prior to December 31, 1986, the net income for income tax purposes will govern the amount of Illinois net loss carryback, so there may still be net income from replacement tax in these years. For these years, under IITA § 203(b)(2)(B), replacement tax deducted in arriving at federal taxable income was added back in the computation of replacement tax base income. For income tax base income purposes, although the actual modifications enforced by the Department changed in this period, the general result (except perhaps in 1979) was that none of the replacement tax deducted in arriving at federal

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taxable income was included in the base. As a result, income and replacement tax base income and net incomes were never identical amounts. For years ending on or after December 31, 1986 the replacement tax subtraction modification to the income tax base was changed to a weighted credit against the income tax. Therefore, as of December 31, 1986, the base income for income and replacement tax purposes is the same. See Chapters 24 and 25 for an in depth discussion of the various modifications and computations involved with replacement tax.

EXAMPLE:

12/31/1986 :	**Co. A**
IL Net Loss	(2,000)

12/31/1983

IT Calculation:		RT Calculation:		
Line 1	2,000	Base Inc Allocable to IL		1,000
Base Income	2,000	RT Deducted from FTI	500	
Apportionment %	.50	Apportionment %	.50	
Base Inc Allocable to IL	1,000	RT Addback		250
IL Net Income	1,000	RT Base Allocable to IL		1,250
IL NLD	(1,000)	IL NLD		(1,000)
Net Income after NLD	-0-	Net Income after NLD		250
		Exemption		100
		RT Net Income		150

Only (1,000) of the INL may be carried back to 1983 for income tax and replacement tax purposes.

Form IL-1120X-PY must be used to amend tax years ending prior to December 31, 1986 for any federal or Illinois change. REF: Informational Bulletin FY88-1.

F. Real Estate Mortgage Investments Conduit (REMIC)

1. Background

On August 23, 2011, PA 97-507 added IITA § 207(e), effective retroactively, to allow REMIC owners to adjust their Illinois income due to disallowed deductions or losses, that would otherwise be allowable, except for IRC limitations, which prohibit taxable income of the REMIC holder from being less than the excess inclusion amount derived from the REMIC. REF: IL-1120 Instructions

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Under IRC § 860E(a)(1), the income of the residual interest owner of a REMIC cannot go below the "excess inclusion" amount, which is equal to its income from the REMIC minus a fair return imputed on its investment in the REMIC. Under IRC § 860E(a)(3), the excess of this floor amount over what the owner's income would be without the floor is treated as a net operating loss that can be carried over to other years. Accordingly, the floor does not create federal taxable income; it only shifts deductions between years.

Before IITA § 207(e) was enacted, this quirk in the IRC caused an Illinois income tax problem for non-individual taxpayers. Because federal NOLs are disallowed for non-individuals, the deduction-shifting mechanism does not flow through to Illinois. The computation of base income begins by using federal taxable income, which does not take into account all otherwise allowable deductions if IRC § 860E(a)(1) comes into play. And, since federal net operating loss deductions are not allowed for Illinois and the computation of INL starts with the same federal taxable income used in computing base income, the deductions disallowed under IRC § 860E(a)(1) never enter into the computation of net income in later years through a carryforward, the way they do under the federal scheme.

Thus, the IITA was amended to allow the excess inclusion amount to be subtracted in computing the INL for a year when IRC § 860E(a)(1) applies. Under that provision, if the taxpayer already has a net loss for the year in which IRC § 860E(a)(1) disallows them the benefit of some deductions (because they have excess subtractions, for example), the net loss is increased by the apportioned amount of the disallowed deductions. If net income is zero or positive, an INL that equals the apportioned amount of the disallowed deductions is calculated.

2. INL Calculation

Holders of residual interest in a REMIC will compute their income using the 2011 (or after) Illinois Schedule INL. Prior to 2011, no official form was available to perform the income adjustment, but the calculations are correct regardless of tax year, the only difference is the line references would not be relatable to earlier tax years. Auditors will need to adapt based on the written descriptions for the respective lines.

IITA § 207(e) states that in the case of a REMIC holder, the 207(a) loss is equal to the following:

(1) the amount computed in (a) or if that amount is positive, zero

MINUS

(2) the amount computed in (a), minus the amount that would be computed without regard to IRC § 860E

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Under the Illinois provisions discussed above, IRC § 860E(a)(1) and(2) apply in determining a taxpayer's Illinois net income or loss. IRC § 860E(a)(3) does not apply because Illinois does not couple onto IRC § 172 net operating loss rules.

Under IRC § 860E(a)(1), the residual interest holder in a REMIC's taxable income may not be less than the excess inclusion. Under IITA § 203(e) and 86 IAC § 100.5270, this amount is taken into account in determining the taxpayer's Illinois base income by applying the modifications listed within IITA § 203

Example:

Base income with REMIC (calculated with modifications) is	20,000,000
Base income no REMIC (calculated with modifications) is	(112,000,000)

Statutorily the loss calculation is: 0-[20,000,000-(112,000,000)] = (132,000,000)

a) Unitary Filers

If a corporation is part of a federal consolidated group, IITA § 203(e)(2)(E) says it is supposed to compute its federal taxable income as if it was not and never had been consolidated. However, in order to implement unitary apportionment, 86 IAC § 100.5270(a) says that a unitary business group must compute its combined federal taxable income following the consolidated return rules, with some exceptions.

Under IRC § 860E(a)(2), the taxable income of a holder of a residual interest in a REMIC cannot be less than the excess inclusion amount income from the REMIC. If the holder is a member of a federal consolidated group, the group's taxable income cannot be less than the excess inclusion amount.

So if a taxpayer is not unitary with anyone, it has to recompute its federal taxable income as if it was not and never had been consolidated federally, and apply IRC § 860E(a)(2) in doing so. If it is unitary with some entities, but not all of the entities with which it joined in a federal consolidated return, the unitary group has to compute its federal taxable income in the same manner as a federal consolidated group, but exclude the nonunitary members of its federal consolidated group, and apply IRC § 860E(a)(2) in doing so.

So, either way, the incomes or losses of noncombination rule companies are not taken into account by the residual interest holder in computing its federal taxable income and applying IRC § 860E(a)(2) for Illinois income tax purposes. If the separate or unitary federal taxable income is greater than the excess inclusion amount after excluding losses from noncombination rule members of the federal consolidated group from the computation, IRC § 860E(a)(2) does not come into play.

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3. Audit Procedure

In order to properly record any audit changes, the auditor should do the following:

1) Complete Schedule INL to properly calculate the allowable REMIC loss to be used for future years.
2) Add the allowable loss as a separate entry on the audit Schedule ILNLD showing the year the loss was earned and the amount placed in the tax year column in which the loss is able to begin being used.
3) Carry the audit Schedule ILNLD amounts used to the Auditor's Report on the proper line for each respective year.

   Example: Tax year ending 12/31/2015 is audited. A REMIC loss of (50,000) is calculated on Schedule INL. The allowable loss is entered on the audit Schedule ILNLD labeled as "REMIC Loss Earned 12/31/2015", the amount of (50,000) is listed under TYE 12/31/2016. It will be a negative number, either increasing an existing loss for 2016 or decreasing income for 2016. Any excess will be carried forward just like a regular INL.
   On the auditor's report for 2015, the ILNLD line will reflect any allowable normal loss utilized. For tax year 2016, the ILNLD will reflect any allowable loss utilized that was increased by the $50,000.

G. Illinois Net Losses And Combined Illinois Returns

Additional rules apply to those taxpayers that file combined unitary returns (as allowed by IITA § 502(e)) for tax years ending December 31, 1986 and after. These rules do not generally affect the amount of the INL but rather they may affect how quickly the loss is absorbed. Under 86 IAC § 100.2340(c), if a combined return is filed, any INLDs are combined and subtracted from combined Illinois net income - there is no limitation based on individual filers. A pre-12/31/86 net operating loss carried to a post-12/30/86 combined Illinois return will be allowed to offset the total base income of common members (as limited by 86 IAC § 100.2230(b)).

1. Determination of Combined INL and NLD

Under 86 IAC § 100.2340(a), if a combined return is filed, the Illinois net loss and net loss deduction is determined as if the group were one taxpayer.

EXAMPLE:

12/31/2014

IL-1120	**Co. A**	**Co. B**	**Combined**
Base Income			1,000

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Nonbusiness Loss			(600)
Business Income			1,600
Apportionment	.10	.20	.30
Apportioned Income	160	320	480
NB Loss Allocable to IL	(600)		(600)
IL Net Income/(Loss)	(440)	320	(120)

If Companies A and B each file a separate Illinois return, Company A's return would reflect an INL of (440) and Company B's return would reflect Illinois income of 320. If a combined Illinois return is filed then the combined return would reflect INL of (120).

2. Separate INL Carried to Combined Return Year

IITA § 405(b-5) and 86 IAC § 100.2350(a) state that there is no limitation even if a company files a separate apportionment return in the year in which the INL is sustained and then carries this INL to a year in which it is a member of a unitary group filing a combined Illinois return.

If losses are being transferred into a new unitary business group, auditors must verify that all of the loss members are included in the new group to allow all available NLDs to be transferred. It is also important to verify how the loss members were acquired as it is possible that the article of purchase does not allow for prior losses to be used by the new designated agent.

EXAMPLE:

12/31/2014:

Separate IL-1120	**Co. A**	**Co. B**	**Co. C**	**UBG**
IL Net Loss	(170)			
Combined IL-1120				
IL Net Income		100	200	300
12/31/2015 Combined:	**Co. A**	**Co. B**	**Co. C**	**UBG**
Base Income				1,000
Business Income				1,000

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Apportionment	.10	.15	.25	.50
Apportioned Income	100	150	250	500
IL Net Loss Deduction				(170)
IL Net Income				330

Even though Company A filed a separate return in the loss year and Companies B and C filed a combined return, when the loss of Company A is carried to a year in which A,B & C file a combined Illinois return, the Illinois loss is carried forward and offset against the Illinois net income of the combined group. Under 86 IAC § 100.2350(a), it does not matter if Company A had a federal net operating loss in 2015 or that Company A would only have had $100 of Illinois net income if each company had filed a separate Illinois return. As long as the loss company is filing as part of the combined return, there is no restriction based on loss member income.

3. Member's Share of Combined INL

The calculation explained in this section will be relevant for those years in which the Illinois filing member(s) leave(s) a combined group and will be filing a separate return or as part of a different Illinois combined return. When loss companies are included in a new unitary group, the taxpayer should determine the percentage of available NLD to be transferred to the new group. Auditors need to verify that the percentage is correct and if not, adjust accordingly. Only loss members with Illinois apportionment are eligible to receive a percentage of ILNLD to be carried forward.

86 IAC § 100.2350(c)(3) details the calculations to be used to determine the portion of a combined INL attributable to a member. If the combined loss results entirely from a unitary business loss (in other words, there are no nonbusiness or partnership items allocable to Illinois), then each loss member's portion of the combined loss can be calculated by multiplying the combined business loss by each loss member's "separate apportionment percentage". The separate apportionment percentage is merely the member's Illinois numerator over the everywhere denominator of the unitary group or, for 3-factor companies prior to 2001, the member's Illinois property, payroll and sales over the respective property, payroll and sales everywhere of the unitary group.

EXAMPLE:

12/31/2015			
IL-1120	**Co. A**	**Co. B**	**UBG**
Unitary Business Loss			(1,000)
Apportionment	.10	.20	.30

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Apportioned Loss	(100)	(200)	(300)
IL Net Loss	(100)	(200)	(300)

If, however, the combined loss results from any other adjustments (for example, nonbusiness income/loss allocable to Illinois or business income from a nonunitary pass-through entity), the attribution to the member is determined by multiplying the combined INL by the following fraction: the numerator equals the amount that would have been the separate INL of the member and the denominator is the sum of the separate INLs of all members of the group with separate INLs.

EXAMPLE:

12/31/2015 Combined:	**Co. A**	**Co. B**	**Co. C**	**UBG**
Base Income				500
Nonbusiness Loss				(1,000)
Business Income				1,500
Apportionment	.10	.20	.10	.40
Apportioned Income	150	300	150	600
NB Loss Allocated to IL	(550)	(450)		(1,000)
IL Net Loss	(400)	(150)	150	(400)

Company A's attribution: 400/550 X (400) = (291)
Company B's attribution: 150/550 X (400) = (109)
Company C's attribution: 0/550 X (400) = -0-

The INL resulted from the allocation of the nonbusiness loss to Illinois. If a combined return is filed by Companies A, B and C in the year to which the loss is carried, no attribution of the loss is necessary. The (400) INL would be allowed to offset the Illinois combined income in the carry year. However, if all three companies file separate returns in the carry year or if one of the companies leaves the unitary group, the attribution to each member will need to be determined. The next three sections further explain this calculation.

4. Combined INL Carried to Separate Return Year

Under 86 IAC § 100.2350(c)(1), if a combined INL can be carried to a separate return year of a corporation, then the portion of the combined INL attributable to such corporation will be carried to such separate return years.

EXAMPLE:

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IL-1120 Combined				
12/31/2002 :	**Co. A**	**Co. B**	**Co. C**	**UBG**
Unitary Business Income				(10,000)
Apportionment	.10	.20	.40	.70
IL Net Loss	(1,000)	(2,000)	(4,000)	(7,000)
12/31/2000 Combined				
IL Net Income	4,000	3,000		7,000
12/31/2000 Separate			1,000	

Companies A, B and C file a combined Illinois return for 2002 and sustain a combined INL of (7,000). In 2000, Companies A and B filed a combined Illinois return, but Company C filed a separate Illinois return. If the designated agent decides the 2002 INL will be carried back, Companies A and B will be allowed to carryback (3,000) of the combined loss prorated to them and offset the 7,000 in Illinois net income. Company C will have (4,000) in INL allocated to it to offset its 1,000 income in 2000. Even though the 2000 combined return for Companies A and B has Illinois net income remaining after the loss carryback, this income can NOT be offset by any part of Company C's prorated INL. Company C's remaining INL must be carried to another year. If in 2001, Companies A, B and C filed a combined Illinois return reflecting at least 3,000 of Illinois net income, the remaining 2002 net loss can be used to offset this income. (Also see 86 IAC § 100.2350(c)(4)(C))

However, for a carryback to a tax year ended on or after 12/31/85 but before 12/31/86, the entire combined INL incurred (or any portion of it) may be deducted by any member or members in the carryback year up to the amount of the total income or incomes in the carryback years. This position is consistent with Illinois' treatment of the carryforward into unitary filing years of net operating losses incurred in a year in which 100% Illinois filers were precluded from filing as a unitary business group.

EXAMPLE:

IL-1120 Combined				
12/31/1986 :	**Co. A**	**Co. B**	**Co. C**	**UBG**
Unitary Business Income				(150,000)
Apportionment	.333333	.333333	.333333	1.00
IL Net Loss	(50,000)	(50,000)	(50,000)	(150,000)
12/31/1983-Separate Filer	250,000	(50,000)	(50,000)	

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Only Company A's portion of the combined loss (50,000) may be carried back to 1983.

IL-1120 Combined 12/31/1988 :	**Co. A**	**Co. B**	**Co. C**	**UBG**
Unitary Business Income				(150,000)
Apportionment	.333333	.333333	.333333	1.00
IL Net Loss	(50,000)	(50,000)	(50,000)	(150,000)
12/31/1985-Separate Filer	250,000	(50,000)	(50,000)	150,000

The entire combined INL of (150,000) would be available for carryback to offset Company A's Illinois net income for 1985.

5. Change in Combined Return Filers

When an INL is incurred, the only relevant members of the unitary group are the Illinois filers (as opposed to the pre-12/31/86 rules where all members of the unitary group were considered). When a combined Illinois return is filed, all Illinois filers with Illinois apportionment factor numerators for that year are viewed as having incurred an INL (unless its share of the apportioned business loss is offset by nonbusiness income or business income from a nonunitary pass-through entity). When one (or more) of these Illinois filers is subsequently sold, its proportionate share of the INL (and that of the remaining Illinois filers) must be calculated by the auditor under 86 IAC § 100.2350(c)(3) . Documentation of this calculation must be included in the audit file. The auditor is also responsible for verifying that the company leaving the unitary group has carried the correct amount of loss into its subsequent returns. If the loss was correctly carried into the new unitary group, a comment should be made in the Auditor's Comments. If the loss was not correctly carried into the new unitary group, secure a separate track to correct the loss.

The position of the Department in these situations is that the taxpayers must work out any discrepancy in their individual desires for absorption of the loss. As long as the loss is carried according to the rules outlined in the regulations, a claim will be allowed.

EXAMPLE:

12/31/2000 :	**Co. A**	**Co. B**	**Co. C**	**Co. D**	**Co. E**	**UBG**
IL Net Income	100	100	300			500
12/31/2002						
Group I IL NL	(100)	(200)		(400)		(700)
Group II IL NL			(300)		(100)	(400)

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Companies A and B may carryback their proportionate shares ((100) and (200) respectively) of the combined loss to 2000. Company C would also be allowed to carryback its proportionate share of the combined loss to 2000. However, the TOTAL carryback deduction allowed to 2000 for both groups would be (500). The designated agents of each of the groups in 2002 will have to agree on how the 2002 losses will be carried. The Department would merely make sure that the regulations are being followed (i.e. carryback to the third year, carryback limited to the amount of income, etc.) Either group in 2002 may elect to forego the carryback period - the election is separate for each group. In other words, Group I may carryback the applicable 2002 INL while Group II elects to carryforward its 2002 INL.

6. Member Not in Existence in Carry Year

Under 86 IAC § 100.2350(c)(2), if a member was not in existence in a prior separate return year, and:

- If the member became part of the unitary group immediately after its organization, then its portion of the loss can be included with the combined carryback to the year it was not in existence. This treatment is the same as that allowed for federal net operating losses under federal Regulation 1.1502-79(a)(2).

  OR

- If the member did not become part of the unitary group immediately after its organization, then its portion of the loss can only be carried back and offset against its separate income.

EXAMPLE:

12/31/2002 :	**Co. A**	**Co. B**	**UBG**
IL Net Loss	(100)	(200)	(300)
12/31/1999			
IL Net Income	200	(Co. B. not yet formed)	
IL NLD	(200)		
12/31/2000			
IL Net Income	100	100	200
IL NLD		(100)	

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Companies A and B incur a combined INL of (300) in 2002. The designated agent decides to carryback the loss. In 1999, Company A filed a separate return. Company B was formed in 2000 and became a part of the unitary group immediately after its organization; therefore, the INL carryback to Company A's return for 1999 is (200), representing a portion of each member's INL from 2002.

If Company B had filed a separate return in 2000 (the year in which it was organized) and subsequently filed as part of a unitary group with Company A in 2001, the loss carryback to 1999 would be limited to Company A's portion of the loss (100).

86 IAC § 100.2350(c)(2) would also cover the situation in which a corporation spins off a division and the new corporation becomes part of the unitary group immediately after its organization.

EXAMPLE:

Corporations A and B filed separate unitary returns for the 1999 tax year and combined unitary returns for the 2000 and 2001 tax years. On January 1, 2002, Corporation B spun off part of its operations to a wholly-owned subsidiary, Corporation S, in a nontaxable reorganization. Corporations A, B and S file a combined unitary return for the 2002 tax year - Corporation S incurs an INL for 2002. The 2002 INL attributable to Corporation S may be carried back to offset the separate income of Corporation A and/or B in 1999 and, if there is an excess loss remaining, to 2000 and 2001. The designated agent for the combined group of ABS will decide how the loss will be carried back.

7. Part Year Members

86 IAC § 100.2350(c)(4)(D) gives an example of how to handle a situation in which members are part of the UBG for a partial year.

H. Schedule NLD

Schedule NLD (or UB/NLD for unitary filers) is used to calculate the amount of Illinois net loss available, deductible and remaining for use in subsequent years. If a taxpayer does not attach a completed Schedule NLD to the IL-1120, or attaches a taxpayer produced schedule that is not authorized by the Department, the INLD claimed will be reduced to zero and considered a math error subject to the math error statute of limitations, collection procedures, etc. REF: Instructions to Schedule NLD. See Chapter 20 for an in-depth discussion of math errors.

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This schedule is fairly self-explanatory. Complete copies of the original loss year returns, amended returns or prior audit reports reflecting the loss amounts claimed may be required to verify this schedule.

All audits that have either net loss periods or net loss deductions being brought into them MUST have NLD schedules prepared to verify the correct loss application and the amount of NLD available to be carried forward. A screen shot of the NLD schedule from GenTax is not acceptable as an NLD schedule to support the audit results. The most up to date version of the NLD schedule is available in APT. Refer to the APT Reference Guide on the intranet for detailed instructions on accessing "The Bundle" in APT where the management approved INLD schedule can be found. This is the only INLD schedule that should be used and included in an audit file.

V. AUDIT PROCEDURE FOR LOSSES

If an Illinois net loss or federal net operating loss is carried back to prior years, the loss should be audited and the loss carryback verified in the current audit. If the loss is carried forward and the carryforward year is part of the current audit period, then again the loss should be audited and the carryover verified. A loss schedule must be prepared to show the losses and the years to which they are carried.

If the carryforward year is not part of the current audit period because the loss has not yet been carried forward, and the audit only includes INL years, an audit should be completed on the loss year if there is any question regarding the unitary filing or group composition of that year. An audit should also be completed on the loss year when the carryforward years are part of the audit but any adjustment to the loss will not sufficiently reduce the carryforward to create a liability in those years.

A. Limitations on Adjusting IL Net Losses

1. IITA § 905(N) AND 911(H)

Public Act 92-0846 enacted on August 23, 2002, added IITA §§ 905(n) and 911(h). These sections impose additional special limitation periods for adjusting INLs. As originally enacted these new sections were applicable to all returns and audits for which a Notice of Deficiency was issued on or after August 23, 2002, and to all claims filed on or after August 23, 2002.

PA 94-0836 effective June 6, 2006, limited IITA § 905(n) to loss years ending prior to December 31, 2002. This makes the change retroactive and allows the taxpayer or the Department to correct a loss for tax years ending on or after December 31, 2002,

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even if that loss year is expired and no Loss Reduction (LR) letter was provided to the taxpayer.

2. Loss Years Ending On or After December 31, 2002

For audits that include INL carryovers from tax years ending on or after December 31, 2002, the INLs can be adjusted without regard to IITA § 905(n). Therefore for these loss years, including years that are closed to statute, INLs may be adjusted for the following reasons:

- Federal taxable income changes
- Nonbusiness income and modification changes
- Apportionment changes
- Unitary group member changes (if the loss year is within statute)

Taxpayers can increase or decrease their loss year return at any time, but if the carryback or carryforward year is expired, then in order for the statute to reopen on the carry year for refund, the increased INL has to be from an RAR that was reported under IITA § 506(b) on an IL-1120-X within 2 years and 120 days of the RAR finalization date. If the carry year is expired, the INL must still be carried to reduce income and may offset a liability, including an audit liability in the carry year, but no refund will be allowed.

Audit has encountered instances where a federal RAR adjustment for one year lumps together FNOL adjustments from multiple years. Because the federal adjustment is not applied to each year individually, problems may occur when attempting to make Illinois adjustments due to statutes not opening for the years outside the RAR. However, there should still be available documentation from the RAR to justify the adjustments.

EXAMPLE: For 2014 the taxpayer timely files an IL-1120 showing an INL of (10,000) and carries that loss to the 2015 IL-1120 to offset Illinois net income of $20,000. At the time the audit is started the 2014 return is out of statute but the 2015 return is in statute. The auditor examines both years and determines that the taxpayer actually should have reported an INL of (15,000) for 2014 and Illinois net income of $30,000 for 2015. Nothing in the statute prevents the auditor from preparing an IL-1120-X for 2015 and increasing the amount of the INL, and then carrying that loss to another year. Even if the taxpayer does not agree to the audit, the increased (5,000) in INL for 2015 will still be carried forward and used as an offset against the 2015 income in computing the NOD.

EXAMPLE: For 2007 the taxpayer claimed an INL carryover from 2001 of (100,000) and an INL carryover from 2002 of (200,000). The returns for the loss years were timely filed but are now out of statute. The auditor notes that there are questionable

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items of nonbusiness income claimed for both 2001 and 2002. For 2002 the auditor can adjust any items on the return, except change the unitary group, to reduce the INL carried forward. Under IITA § 905(n), a notice of deficiency cannot be issued for 2007 as a result of the adjustment to the 2001 loss unless the Department issued the taxpayer a LR letter while the 2001 return was in statute.

EXAMPLE: In June of 2017 an audit is started on ABC Corp for calendar years ending 2013 and 2014. The taxpayer was not previously audited. GenTax shows that for 2014 the taxpayer carried over an INL in the amount of (8,000). After reviewing the taxpayers filing history, the auditor discovers that 2011, 2012 and 2013 are non-filed although GenTax shows that $3,000 in estimated payments had been made for both 2012 and 2013. There is no extension for any of these years, so the general 3-year limitations period for refund claims had expired for 2011 and 2012 before the audit commenced and the limitations period for 2013 will expire on October 15, 2017, unless an extension agreement is executed. The auditor determines the following amounts for 2011 through 2014.

ABC Corp	Non-filed	Non-filed	Non-filed	Per GenTax
Description	2011	2012	2013	2014
Federal taxable income	(200,000)	120,000	60,000	300,000
Net modifications	20,000	(30,000)	10,000	(20,000)
Base Income	(180,000)	90,000	70,000	280,000
IL Factor	40.0%	40.0%	40.0%	40.0%
Net Income	(72,000)	36,000	28,000	112,000
INL carryover to 2006	36,000	(36,000)		
INL carryover to 2007	28,000		(28,000)	
INL carryover to 2008	8,000			(8,000)
Subject to tax	0	0	0	104,000
7.3% tax	0	0	0	7,592
Estimated payments	0	3,000	3,000	5,000
Other payments	0	0	0	2,592
Total Payments	0	3,000	3,000	7,592
Pending Refund	0	(3,000)	(3,000)	0

- The auditor will prepare an original IL-1120 for 2011, 2012 and 2013 showing the above figures.
- The 2011 INL must be carried to 2012, 2013 and 2014 and will offset any balance due in the carry years
- No refund of the estimated payments will be permitted for 2012 or 2013,
  -

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- The auditor will indicate on the IL-1120 for 2012 and 2013 that the overpayment of $3,000 for each year is not refundable due to IITA § 911(h).
- For 2014 the taxpayer gets only (8,000) of the 2011 INL because the remaining amount must be carried to 2012 and 2013
- No refund is allowed for any year due to the loss year return not being filed within 3 years of the extended due date. (IITA § 911(h))

Note: If there is a future underpayment from an RAR in 2012 and 2013, the $3,000 in estimated payments for that year may be used to offset any additional liability for that year.

3. Loss Years Ending Prior To December 31, 2002

IITA § 905(n) provides that on and after August 23, 2002, no notice of deficiency can be issued as the result of a decrease in the INL incurred by a taxpayer in any taxable year ending prior to December 31, 2002 unless the Department notified the taxpayer of the proposed decrease within the statute of limitations period for the loss year (LR Letter Procedures).

IITA § 905(n) limits the time period for the Department to reduce the amount of INL available to carry. Therefore, upon receipt of an audit assignment, the auditor should immediately determine whether the statute of limitations is open for loss years prior to December 31, 2002 in which the taxpayer has reported an INL. If a loss year ending prior to December 31, 2002 is still within statute, the auditor must secure a waiver on the loss year return before the statute of limitations expires, or issue to the taxpayer the EDA-143-LR letter from GenTax.

IITA § 911(h) provides that on or after August 23, 2002, no claim for refund will be allowed to the extent the refund is the result of an amount of INL incurred in any taxable year ending prior to December 31, 2002 that was not reported to the Department within three years of the extended due date of the loss year return on either the original return filed by the taxpayer or on an amended return. Or, if the refund is the result of an amount of INL incurred in ANY taxable year for which no return was filed within 3 years of the extended due date of the return for the loss year. If the original return is filed more than three years after the extended due date, the INL would still be carried and can offset a balance due in the carry year or to offset an audit or federal change increase in net income. The taxpayer can even pay no estimated tax in a year if the carryforward deduction will eliminate its income for the year. IITA § 911(h) only prohibits using the carryforward to generate a refund in the carry year.

Extra precautions are warranted with audits that have either a loss year as part of the audit period, or have any loss carried into the audit period from tax years ending prior

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to December 31, 2002. For example, the current audit assignment has a tax impact as a result of decreases to INLs carried over from two different prior audit cycles. The auditor must verify that proper LR notification was given on each loss year ending prior to December 31, 2002, that was changed during each of the prior audit periods. If a proper LR notification on the loss years was:

- Given in the prior audits, a NOD may be issued based on the corrected losses.
- Not given in the prior audits, we are prohibited from issuing a NOD based on the changes from the corrected loss amounts being carried into the current audit. The as-filed loss figures must be used.

a) Loss Year in Statute

If the statute is open for the prior to December 31, 2002 loss year, the auditor must obtain a waiver to extend the statute for those years that will expire within six months. Waivers are necessary for loss years ending prior to December 31, 2002, as well as income years. Waivers on original returns and Federal RAR statutes will allow for changes to the loss year(s) beyond the 3-year period in IITA § 905(n). Refer to Chapter 21 – Extensions – Form IL-872 for further details.

If the auditor obtains a waiver or there is an LR letter on file, adjustments to the losses can be made based upon the audit findings.

- If the taxpayer agrees with the audit, the auditor must obtain a signed IL-1120-X for the loss year reflecting increases or decreases to the loss.
- If the taxpayer disagrees with the audit findings after the auditor has obtained a waiver and completed the audit, the auditor must give the taxpayer the EDA-143-LR letter along with workpapers reflecting the corrected decreased loss amounts.
  - If the audit findings increase an INL, a signed amended return must be obtained.
  - If the taxpayer will not sign an IL-1120-X, the INL increase will not be processed.

b) Loss Year Past Statute

If a loss year ending prior to December 31, 2002, is past statute, the auditor must verify that an audit was completed and proper notification for a decrease to the loss year(s) was given to the taxpayer during the statutory period. Check AIS or GenTax for prior audit history. If there was no prior audit activity, the loss for tax years ending prior to December 31, 2002, cannot be adjusted and the auditor must use the as-filed figures.

If changes were previously made to the losses (LR audits) that the taxpayer did not agree with, the auditor will determine if the changes were made to decrease the

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loss year(s) in accordance with IITA § 905(n). The auditor must determine if the prior audit changes to the losses were made:

- Within 3 years of the extended due date,
- Within the waiver period,
- Due to a timely filed RAR change, or
- Within one year of an amended return.

In the event that the taxpayer disagrees with the audit on the carry year, then there should be documentation in the audit file that the taxpayer was timely notified of the loss reduction.

Proper Notification by any of the following would be acceptable notification of changes to the loss years if made within the required time period:

Unagreed Situations:

- The issuance of an LR letter to the taxpayer (signed or unsigned);
- An unsigned auditor-prepared IL-1120-X;
- EDA-25 auditor's reports reflecting the loss year reduction;
- Any written correspondence to the taxpayer explaining the loss reduction;
- Any written documentation in the EDC-5 that verifies that workpapers were given to the taxpayer on a particular date within the required period;
- Auditor-prepared spreadsheet with loss year reductions,

Agreed Situations:

- The completion of an agreed audit, and
- A timely filed IL-1120-X;

If LR notification was timely issued, notification would be considered given for the loss years listed in the LR letter. If multiple audit cycles have been completed, LR notification must have been issued for each tax loss year in each audit cycle.

LR notification covers the entire unitary group and any members that have been added/deleted from the group in the course of the audit. Verbal notification within the statutory period is not considered adequate notification under IITA § 905(n).

If proper notification was not timely given to the taxpayer, IITA § 905(n) prohibits the Department from issuing a Notice of Deficiency based on a reduction in the Illinois net loss from the amount reported by the taxpayer. That does not entitle the taxpayer to claim a refund based on the carryforward of an erroneous amount of loss. For example, assume the taxpayer reported a $1 million INL in 2000, which it carried to 2001 when it had $3 million in net income before INLD, resulting in net income of $2 million. If the Department fails to issue a timely notification before determining that the taxpayer actually had no loss, the Department cannot issue a

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Notice of Deficiency for 2001. However, if the taxpayer has a federal change that reduces its 2001 net income before INLD to $2.5 million, the Department can disallow the refund claim because the taxpayer's correct net income is $2.5 million and it has actually underpaid its tax. If the federal change reduces the taxpayer's 2001 net income before INLD to $0, the Department must allow the refund because the taxpayer is overpaid, but it can deny any refund the taxpayer might claim by carrying forward the 2000 INL "freed up" by the 2001 federal change.

Following is a "Loss Year" flow chart reflecting how IITA § 905(n) will be handled for situations where the Notice of Deficiency has been or will be issued on or after August 23, 2002.

NOTE: THE FLOWCHART BELOW ONLY APPLIES TO LOSSES THAT ARE CARRIED FROM TAX YEARS ENDING PRIOR TO DECEMBER 31, 2002

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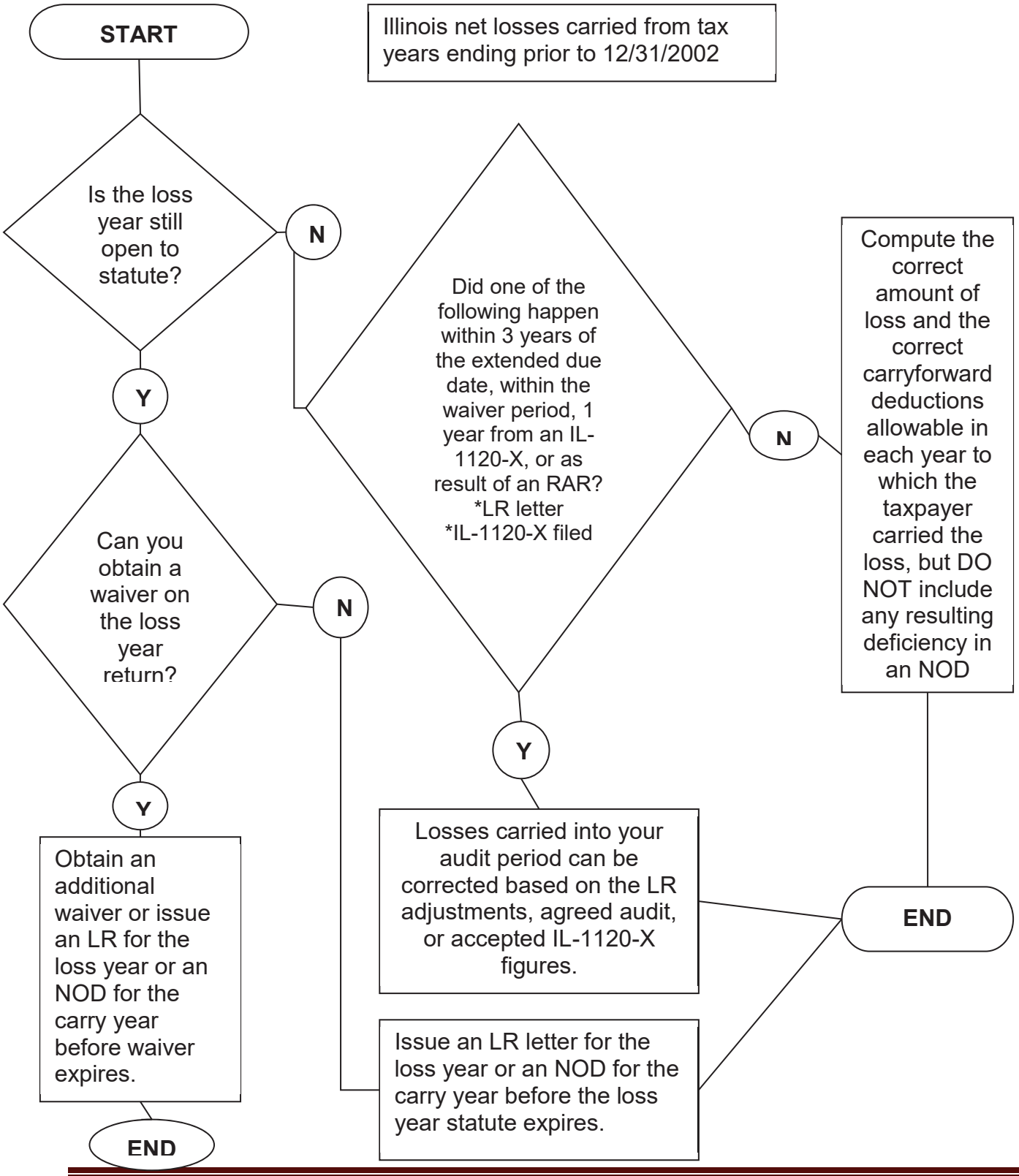

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c) Non-Filed Loss Year Returns and Amended Returns Increasing Losses

IITA § 911(h) requires that taxpayers report net losses to the Department within three years of the extended due date for the loss year return. If no original loss return is timely filed or if an amended return increasing a reported loss is not timely filed, the taxpayer cannot claim a refund in a carry year based on applying the unreported loss.

Even though the loss year is past statute, an original return must still be secured to establish the past-statute filing on the system. The INL will be properly carried forward or back, but no refund of tax payments will be allowed in any carry year. The correct amount of loss can be used to reduce or eliminate deficiencies resulting from federal changes or audit changes.

EXAMPLE: NON-FILED LOSS YEAR PAST STATUTE

	~~	**As Filed**	~~~~~~~~	**As Filed**	~~~~~~~~
	2001	2002	2003	2004	2005
	Not Filed	Filed	Filed	Filed	Filed
IL net income/loss	(1,000,000)	(2,000,000)	500,000	1,300,000	800,000
2002 to 2003		500,000	(500,000)		
2002 to 2004		1,300,000		(1,300,000)	
2002 to 2005		200,000			(200,000)
Balances	(1,000,000)	0	0	0	600,000
Original tax paid at 7.3%					43,800
	~~	**Per Audit**	~~~~~~~~	**Per Audit**	~~~~~~~~
	2001	2002	2003	2004	2005
	IL-1120	Filed	Filed	Filed	Filed
IL net income/loss	(1,000,000)	(2,000,000)	500,000	1,300,000	800,000
2001 to 2003	500,000		(500,000)		
2001 to 2004	500,000			(500,000)	
2002 to 2004		800,000		(800,000)	
2002 to 2005		800,000			(800,000)
Balances	0	(400,000)	0	0	0
Tax Overpayment					(43,800)

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For 2001 the taxpayer failed to file their original IL-1120, and the year is now more than three years past the extended due date. On the original returns as filed the taxpayer carried forward their 2002 INL which is all used in 2005 resulting in tax paid in 2005 of $43,800.

The auditor prepares an original 2001 IL-1120, which the taxpayer signs but it is past statute. The auditor will carry the 2001 loss to 2004, but the increased 2002 loss carryover to 2005 results in an overpayment in 2005. Although the 2005 refund is actually due to losses carried over from 2002, it is still the result of the increased loss being carried over from 2001 which is not subject to refund.

The auditor will include the $43,800 overpayment on the 2005 IL-1120-X, but will note in the comments section that the amount is out of statute for refund. An IL-1120-X is used because the EDA-25 and IL-870 are generally only used for an NOD or refund. Since there is no refund, the IL-1120-X for 2005 does not need to be signed by the taxpayer.

If the auditor is adjusting a specific year for an out-of-statute adjustment, that year must also be included in the audit period. If the taxpayer fails to sign the IL-1120 for 2001, the auditor should still carry the 2001 loss.

<u>EXAMPLE</u> – NONFILER FOR LOSS YEAR:

The auditor is assigned an audit on 11/01/2017 for the tax years 12/2014 – 12/2015 with the following information on the original returns:

Tax Years	12/31/2013	12/31/2014	12/31/2015
Statute Date	Non-filer	10/15/2018	10/15/2019
Original Returns:			
Income/Loss	0	250,000	60,000
INL c/f 12/13 to 14	0	(30,000)	
Net Income(loss)	0	220,000	60,000
As Audited:			
Income/Loss	(30,000)	250,000	60,000
INL c/f	30,000	(30,000)	
Balance	0	220,000	60,000

- The taxpayer did not file the 12/2013 return which had a loss of (30,000);
- The 12/2013 INL was claimed on the original 12/2014 return;
- Per IITA § 911(h), the auditor must secure the 12/2013 return prior to three years from the extended due date (10/15/2017), in order for the taxpayer to be able to claim a refund on the 12/31/2014 return;

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- The INL for 12/2013 will still be carried to 12/2014, but no refund will be allowed for any estimated payments made in 12/2014. The 2013 loss is still carried if the taxpayer will not sign the 2013, IL-1120.

<u>EXAMPLE</u> – PRIOR AUDIT CHANGED LOSS YEAR
NO TAX EFFECT
LR NOTIFICATION ISSUED

- In an audit on the tax years 12/2000 – 12/2002, an INLD was claimed in 12/2000 for a loss carried forward from 12/1998 (statute expired on 10/15/2002);
- The 12/1998 return was previously audited and resulted in a decrease to the loss of $50,000. There was no tax effect for this change in the prior audit;
- The taxpayer did not agree with the prior audit changes, and did not sign an IL-1120-X to reduce the loss.
- The taxpayer was given LR notification within statute on 9/30/2002.
- The taxpayer refused to sign the LR letter, but the prior audit(s) had documentation that proper LR notification was given and commented on the EDC-5;
- The current auditor will be able to utilize the prior audit loss figures because the LR notification was given within the period required by IITA § 905(n).

<u>EXAMPLE</u> – PRIOR AUDIT CHANGED LOSS YEAR
TAX EFFECT
NOTICE OF DEFICIENCY ISSUED

- A current audit was assigned on the tax years 12/2000 – 12/2002;
- A prior audit was conducted on 12/1996-12/1999
- Tax year 12/1996 was an income year, and tax years 12/1997, 12/1998 and 12/1999 were loss years. The auditor had a waiver on the 12/1996 income year until 10/15/2002, but did not include any of the loss years on the waiver;
- On the taxpayer's 12/2000 original return, an INLD was taken from the remaining loss available to be carried forward from 12/1997;
- On their original 1998 return taxpayer made the election to forego any carryback.

Original Returns:					
	12/31/1996	12/31/1997	12/31/1998	12/31/1999	12/31/2000
Statute Date	10/15/2002	10/15/2001	10/15/2002	10/15/2003	10/15/2004
Inc(Loss)	20,000	(75,000)	(5,000)	(10,000)	30,000
97 c/b 96	(20,000)	20,000			
97 c/f 00		30,000			(30,000)
Remaining Inc(Loss)	0	(25,000)	(5,000)	(10,000)	0

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As Audited:					
	20,000	(15,000)	(5,000)	(10,000)	30,000
97 c/b 96	(15,000)	15,000			
98 c/f 00			5,000		(5,000)
99 c/f 00				10,000	(10,000)
Remaining Inc(Loss)	5,000	0	0	0	15,000

- The prior audit on the 12/1997 return resulted in a decrease to the loss from ($75,000) to ($15,000).
- A tax effect occurred in the prior audit when the loss carry back to 12/1996 was reduced from $20,000 to $15,000.
- The taxpayer did not agree with the changes, did not sign an IL-1120-X to reduce the 12/1997 loss and did not sign an IL-870 for the carryback reduction to 12/1996.
- The 12/1996-12/1999 audit was closed as unagreed and the taxpayer was given LR notification by the prior auditor on 7/1/2002 (past statute);
- A Notice of Deficiency was issued on 8/5/2002 for the 12/1996 tax year (the year of tax impact from the prior audit loss change).
- Since the Notice of Deficiency on the 12/1996 return was issued prior to the August 23, 2002 effective date for IITA § 905(n), the auditor is not bound by the requirements of IITA § 905(n).
- The auditor will still be able to utilize the prior audit corrected loss numbers. IITA § 905(n) does not apply. The 12/2000 return should be corrected to only show the carry forward from 12/1998 and 12/1999.

EXAMPLE – RAR INCREASE TO A LOSS:

- For 12/31/1999, the taxpayer had income and it was the first year of operations
- The taxpayer has a loss on the 12/2000 original return;
- Both original returns were filed by the extended due date;
- The 12/2000 INL was carried back to the 12/1999 return;
- On 12/15/2004, the IRS completes an RAR on 12/2000 increasing their loss by (50,000);
- IITA § 905(n) and 911(h) both apply since the years are prior to December 31, 2002. The RAR holds open the IITA § 911(h) requirement to adjust the loss year, allowing the taxpayer to file an amended return for the loss year.

Tax Years	12/31/1999	12/31/2000
Statute Date	10/15/2003	10/15/2004
Original Return		
Income/Loss	300,000	(100,000)
12/00 INL c/b to 12/99	(100,000)	100,000

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	200,000	0
RAR change 12/15/2004		(50,000)

- IITA § 911(h) does not prohibit the RAR change to 12/2000 since the original return reporting the loss was filed within the required 3 years from the extended due date.

  If the normal statute on the carryback year is expired, IITA § 911(g) allows the taxpayer to carry back the additional $50,000 to the 12/1999 return for a refund as long as the amended return is filed within the time period allowed under IITA § 506(b), which is 2 years and 120 days from the federal finalization date.

EXAMPLE – RAR DECREASE TO A LOSS:

- Taxpayer has a loss on the 12/1999 original return and income on 12/2000;
- The 12/1999 INL was carried forward to the 12/2000 original return;
- On 12/15/2004, the IRS completes an RAR on 12/1999 resulting in a decrease to the loss from (100,000) to (80,000)
- The taxpayer did not report the RAR;
- The taxpayer timely sends the auditor an IL-1120-X for the loss year, which the auditor will verify in audit;
- IITA § 506(b) holds open the statute to adjust the loss year.

Tax Years	12/31/1999	12/31/2000
Statute Date	10/15/2003	10/15/2004
Original Return		
Income/Loss	(100,000)	500,000
12/99 INL c/f to 12/00	100,000	(100,000)
	0	
RAR change	20,000	
Corrected Income/Loss	(80,000)	500,000
12/99 INL c/f to 12/00	80,000	(80,000)

The 12/31/1999 (100,000) carry forward to 12/31/2000 will be reduced to (80,000) since the statute is open under IITA § 905(d) for the unreported federal change. IITA § 905(n) does not prohibit the change.

EXAMPLE – MISAPPLIED LOSS CARRYFORWARD:

- A taxpayer has carried losses into the 12/2000 tax-year from two different tax periods: 12/1998 and 12/1999.
- The auditor has a waiver on the 12/2000 return to hold open the statute;
- The auditor agrees with the losses as filed for both years;

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- The taxpayer has misapplied the loss for 12/1998 by not checking the box to forego the carryback period.

Tax Years	12/31/1996	12/31/1997	12/31/1998	12/31/1999	12/31/2000
Original IL Inc	100,000	50,000	(150,000)	(50,000)	400,000
98 INL c/f 00			150,000		(150,000)
99 INL c/f 00				50,000	(50,000)
Inc/(loss) Remaining	0	0	0	0	200,000

- The 12/1998 loss should have gone back to offset income on the taxpayer's 12/1996 and 12/1997 returns as follows:

Tax Years	12/31/1996	12/31/1997	12/31/1998	12/31/1999	12/31/2000
Original IL Inc	100,000	50,000	(150,000)	(50,000)	400,000
98 INL c/b 96	(100,000)		100,000		
98 INL c/b 97		(50,000)	50,000		
99 INL c/f 00				50,000	(50,000)
Inc/(loss) Remaining	0	0	0	0	350,000

In this example, no changes were made to the loss years. Therefore, IITA § 905(n) and 911(h) do not apply. Since the 12/2000 return is still in statute by waiver, the auditor may correct the 12/2000 return to remove the 12/1998 loss and allow only the carry forward from 12/1999. The statute will not be opened to allow the taxpayer a refund for carrying the loss back to 12/1996. However, EDA-25's should be prepared to show the application of the 12/1998 loss to 12/1996 and 12/1997. The taxpayer is not entitled to a refund for 12/1996 and 12/1997 because they are out of statute.

<u>EXAMPLE</u> – ERRONEOUS REFUND FOR MISAPPLIED LOSS CARRYBACK:

- The audit period is for calendar years 1998, 1999 and 2000.
- The first two years of the audit have income.
- The taxpayer has filed IL-1120-X's for 1998 and 1999 on 10/15/2002 for the loss carryback.
- Both refunds were issued on 3/15/2003.

Tax Years	12/31/1998	12/31/1999	12/31/2000
Statute Date	10/15/2002	10/15/2003	10/15/2004
Original federal Income/Loss	100,000	100,000	(150,000)
Apportionment factor	0.50	0.50	0.50

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Illinois net income/loss	50,000	50,000	(75,000)
C/B claim filed 10/15/2002	(50,000)	(25,000)	75,000
Net income after INLD	-	25,000	-
Amount Refunded	50,000	25,000	

The auditor has determined that the loss was incorrectly carried back because the CPA was unaware that there was a federal Form 1120-X previously filed for 1998 that increased taxable income by $50,000 (assume the X was not the result of an RAR). As a result, the auditor has determined that the loss should have been carried back as follows:

Tax Years	12/31/1998	12/31/1999	12/31/2000
Statute Date	10/15/2002	10/15/2003	10/15/2004
Original Federal Income	100,000	100,000	(150,000)
Non-RAR US 1120-X Adj.	50,000		
Adj. Federal taxable income	150,000	100,000	(150,000)
Apportionment factor	0.50	0.50	0.50
Illinois net income/loss	75,000	50,000	(75,000)
Corrected carryback	(75,000)		75,000
Net income after carryback	-	50,000	-
Erroneous Refund		25,000	

Although there is still no tax due for 1998, there was an erroneous refund issued in 1999.

- EDA-25's and an IL-870 should be prepared to correct the application of the loss.
- Because the federal Form 1120-X for 1998 reduced the loss available to carry to 1999, the acceptance of the return by the IRS is a federal change for 1999
- IITA § 905(d) allows the issuance of an NOD at any time for the resulting deficiency in 1999 if the Department was not notified of the change within two years after the filing date of the report to correct the previously filed return(s).
- There are no changes to the loss year, thus IITA § 905(n) is not applicable.

<u>EXAMPLE</u> – UNREPORTED CAPITAL LOSS:

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- The taxpayer has an unreported capital loss for the 12/2000 return.
- There are timely waivers with the IRS holding open the statute for the 12/1997 return.
- US1120-X for the 12/2000 return to report the capital loss was filed on 12/30/2002.
- No IL-1120-X is needed for 12/2000 since the capital loss did not change federal taxable income in 12/2000.
- Amended returns to carry back the capital loss to 12/1997 were filed both federally and for Illinois.
- The original 12/1997 Illinois return has a substantial subtraction modification for US Government interest and after applying the capital loss to federal taxable income, the taxpayer now creates an INL.
- The taxpayer will be able to apply the capital loss and receive a refund for 12/1997;
- The taxpayer will be able to carry forward the newly created INL because it was created as a result of a federal change, per IITA § 911(b).
- If the IL-1120-X for 12/1997 is sent to the field for audit, the auditor can make any change to the return to reduce the claim to zero. Since these changes would also change the INL for 12/1997 tax year, any year to which the 12/1997 loss was carried should also be audited to reduce the INL.

<u>EXAMPLE</u> – TAXPAYER FILES AMENDED RETURN PAST 911(H) PERIOD

- The taxpayer timely filed an original return for 12/1995 reflecting a loss and an original 12/1996 return reflecting income with a loss carryforward from 12/1995.
- On 12/5/1999 (past statute), the taxpayer filed an amended return for 12/1995 to increase the loss by $(60,000) due to a missed subtraction modification.
- On 1/20/2003, a federal audit was completed on the 12/1996 return. The taxpayer reported the federal change on an amended return dated 2/10/2003 (within statute).

Tax Years	12/31/1995	12/31/1996
Statute Date	10/15/1999	10/15/2000
Original Return		
Income/Loss	(10,000)	20,000
12/95 INL to 12/96	10,000	(10,000)
Sub Total	0	10,000
Non RAR IL-1120-X	(60,000)	
RAR Change		30,000
Remaining Income(Loss)	(60,000)	40,000

- The auditor should allow the carry forward of $40,000 of the 12/1995 INL to 12/1996 (the original $10,000 plus $30,000 from the RAR Change),

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- The carry forward can only offset the balance due from the RAR.
- Since the 1995 IL-1120-X is past statute and the adjustment is non-RAR, the taxpayer cannot carry the increased INL forward for a refund in the carry year, even if the carry year is within statute.
- The taxpayer did not report the 12/1995 non-RAR changes to the loss year by filing an amended return within the required 3 years from the extended due date per IITA § 911(h).
- When carrying losses GenTax cannot keep track of the portion of overpayments that are nonrefundable; therefore the EDA-25 will have to indicate the portion of the refund that is non-refundable under IITA § 911(h).
- Also see example "NON-FILED LOSS YEAR PAST STATUTE"

B. When to Issue an EDA-143-LR Results – Net Loss Info

1. LR Letter Procedures

If the auditor is correcting an Illinois net loss (INL) or tax credits for a year in which there is no tax liability, and the taxpayer agrees with the changes, the auditor must obtain a signed amended return (not an IL-870) to correct the INL or credits. The taxpayer will then carry over the correct amount of INL or credit based on the amended return.

If the taxpayer does not agree with the auditor's changes for years in which there is no tax liability due, then the taxpayer must be given an EDA-143-LR Net Loss and Credit Reductions. This letter provides written notification to the taxpayer that the Department does not agree with the return(s) as filed. The taxpayer should understand that signing the letter does not indicate agreement with the Department's position; it is merely proof that the taxpayer was notified of the change that will be made to the INL or credit available for carryover. The taxpayer will have the right to protest any change in the carry year in which the adjustment to the loss/credit will create a deficiency.

This letter will be given to the taxpayer at the close of the audit in the event that Illinois net losses or credits have been reduced or eliminated and there was no signed, amended return or agreed auditor's report, or the audit resulted in no additional liability. The auditor must provide the taxpayer with a schedule showing the correct amount of Illinois net losses and/or credits available for carryover. Documentation is crucial given the long time frame allowed for carry over.

a) Separate Unitary

If the taxpayer files separate unitary returns (i.e. separate unitary IL-1120ST), a listing of all of the Illinois filers in the group should be attached to the EDA-143-LR.

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b) Combined Unitary

If the taxpayer files a combined unitary return, only the designated agent needs to be identified on the EDA-143-LR.

If the auditor knows at the time the audit is completed that the INL or credit carryover adjustments will have a tax affect in a subsequent period, then the auditor should extend the audit period to include that subsequent period or order a track for the subsequent period. If there is a gap year that will not be audited, then the auditor will have to request a separate track for that period. If there is no tax effect on a subsequent filed return, either due to negative base income or excess credits, then the subsequent period need not be examined. In that case the audit will be submitted as LR using the procedures outlined above.

Note: There is a taxpayer signature line on the EDA-143-LR; however the taxpayer does not have to sign the form. The taxpayer's signature only indicates proof of receipt. If the taxpayer will not sign it, then the auditor should add a notation at the bottom of the form indicating that the taxpayer received it, the date it was received and the auditor's initials. In addition, a comment should be added to the EDC-5 History Worksheet.

Specific instructions for the EDA-143-LR are found in Audit Manual Chapter 20, Audit Procedures. Refer to the Exhibits section under how to create audit completion letters.

C. Unitary Group Change

Prior to September 29, 2016, Departmental policy prohibited auditors from changing the unitary group as filed in the loss year, IF that year was out of statute to correct. With the revision of 86 IAC § 100.9320, auditors may change the filing status of an out-of-statute loss year if the taxpayer filed as a separate filer and the auditor believes the taxpayer should have been filing as part of a unitary group (or vice versa), or if the auditor disagrees with the unitary group as filed.

In some circumstances, the audit period may contain a current year federal net operating loss or Illinois net loss and the auditor disagrees with the group configuration as filed but a change to the group does not result in additional liability being proposed. (The change merely decreases the amount of applicable loss.) Taxpayer should be notified IN WRITING that the Department does not agree with the loss as calculated and the amount will be adjusted by the Department when it is carried to a succeeding year. An EDA-143-LR Net Loss and Credit Reductions letter will be provided per procedures previously outlined.

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VI. CAPITAL LOSSES

86 IAC § 100.2300(c), applicable to tax years ending December 31, 1986 and after, states that the treatment of capital losses is "separate and apart from the rules governing Illinois net losses and Illinois net loss deductions. Capital losses will continue to be governed by federal provisions." Federal capital loss rules in IRC § 1212 and Regulation 1.1502-22 govern the treatment of capital losses for Illinois, since capital losses are a component of federal taxable income.

Federally, capital losses cannot exceed capital gains for the year. Capital losses may be carried back 3 years and forward 5 years. There is no election to forego the carryback period. A capital loss carryback is limited to the extent of the capital gain in the carry year and may not be used to produce or increase a net operating loss (IRC § 1212(a)(1)(A) (ii)).

Capital loss carryovers are taken into consideration only to the extent that they reduce federal taxable income. They are considered a federal change and would not be allowed for Illinois unless the taxpayer had carried the loss on the federal return. The taxpayer must claim a capital loss carryover within 2 years and 120 days of the federal finalization date. (IITA §§ 506(b) and 911(b)).

If the loss carryback is not identical between federal and Illinois returns or, there is no capital loss for federal purposes, but due to the composition of the unitary group there is a capital loss for Illinois, the taxpayer has 3 years and 20 days from the end of the loss year or 2 years and 20 days from the federal finalization date to carry the capital loss. REF: 86 IAC § 100.2300(c) and 100.5030(b). A waiver on the loss year cannot extend the time frame for carrying an Illinois capital loss. However, if the carry year is still open by waiver, the Illinois capital loss can still be carried.

A. ADJUSTMENT TO CAPITAL LOSS

Capital loss carryback adjustments must be reported on amended returns and include verification of a federal adjustment via RAR and schedules such as Form 1139. Auditors must verify that the capital loss has not been previously carried. In cases where the capital loss was previously carried and the adjustment is changing the carry provisions, all periods that were impacted by the previous carry must be re-evaluated. Furthermore, auditors need to verify when the capital loss became available to be carried and determine what statute date is open to allow the claim.

Copies of federal returns including a Schedule D for both the carry to and from periods should be included in the audit file to verify capital gain/loss amounts.

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1. Federal Form 1139

   The federal Form 1139 schedule is used to determine the amount of capital loss being allowed and from which period(s). These amounts are split from other RAR adjustments to differentiate the two from each other. The separation is necessary as any refund from a capital loss carryback claim will only receive refund interest from the date of request (rec'd date of amended return). This also means the capital loss credit will receive the date of request when posted to GenTax and if that credit is not within 120 days from the RAR finalization date, then it is possible that any RAR tax due will be assessed a late payment penalty. Balance due interest will be assessed on the full tax increase and will accrue from the date of underpayment through the date of capital loss credit and/or payment received dates.

B. Creating an INL By Carrying a Capital Loss

Capital losses can be carried back to offset capital gains, up to the amount of federal taxable income, even if an Illinois net loss results. Federally, capital losses are allowed to the extent of capital gains, but cannot increase or create a federal NOL in the carry year. An Illinois net loss can occur when a federal capital loss is carried back to reduce federal taxable income to zero and Illinois reductions to income exist (i.e. subtraction modifications, non-business income, partnership income, etc.).

C. Application of Capital Losses in Unitary Years

When a taxpayer has both separate company years as well as combined unitary carry years, and the members are the same in the unitary carry and loss years, the application of the capital losses can become confusing. Consider the following example.

EXAMPLE:

Capital (Losses)/Gains (Shown in millions)								
Separate			**/----------Combined Unitary----------**					
	3/12		**3/13**		**3/14**		**3/15**	
	NSI	32	NSI	(4.8)	NSI	27.60	NSI	(33.00)
			NHA	15.6	NHA	59.30	NHA	(25.70)
			NCRA	0.2	NCRA	2.06	NCRA	0.06
			NACC	0.0	NACC	9.80	NACC	0.80
			NGP	2.5	NGP	0.80	NGP	1.00
				13.5		99.56		(56.84)
FTI		10		2.8		194		25

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For 3/12, NSI files as a separate non-unitary company. For 3/13 – 3/15, NSI files a combined unitary return with NHA, NCRA, NACC, and NGP. NSI and NHA incurred capital losses in 3/15.

According to 86 IAC § 100.5270(a)(3), unitary filing does not cause losses to become the property of the group. Therefore, several steps must be followed in order to determine the amount of the loss applicable to each company and to determine the amount to apply in each carry year.

- **Step #1:** In the capital loss year, determine the amount of net gains or losses for each member of the unitary group. Then, net the gains against the losses of all the unitary members to arrive at a net capital loss amount for the entire group. In the example this would be a net ($56.84m) for the group.

- **Step #2:** Pro-rate the capital loss among the loss members of the group. The losses belong to each company; the regulations on combined reporting do not change this. Therefore, each company would own its loss minus its allocated share of the group's gain from that year. Pro-ration is done according to IRS Regulation 1.1502-22(b)(3) (or 1.1502-79A(b)(2) for years prior to 1/1/97). For the example, this would be:
  NSI 33/58.7 x 56.84 = $31.95m
  NHA 25.7/58.7 x 56.84 = $24.89m

- **Step #3:** Carry back the loss to any separate-company years for the individual members that are unitary in the loss year. Three limits must be considered in carrying back the capital loss:
  - the total amount of loss available,
  - the total amount of gain in the carry year, or
  - the total amount of federal taxable income for the company in the carry year, whichever is smallest.

  For the example, NSI would carry back ($10m) loss to offset the 3/12 gain, since the FTI limit amount is the smallest of the three limits. This leaves ($21.95m) ($31.95m available – $10m applied to 3/12) available for NSI to carry forward into unitary years. The other members of the example did not have separate company years, so the first year to apply their losses would be 3/13.

- **Step #4:** Carry the remaining capital losses for the companies into unitary years. Again, three limits must be considered:
  - the amount of loss available for each company,
  - the gain amount for each company in the carry year, and
  - the total amount of federal taxable income for the group in the carry year, whichever is smallest.

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First look at each individual company in the unitary carry year, offsetting up to the limits. Then, look at the entire group, taking into consideration the federal taxable income limit for the group. Capital losses of one member can be offset against the capital gains of other members of the unitary group (following IRS Regulation Section 1.1502-22) as if the Illinois unitary group constituted a federal consolidated group. For the example, we first look at NSI and NHA. NSI has a capital loss for 3/13, so nothing would be offset from its 3/15 loss. The remaining ($21.95m) capital loss for NSI will be carried into the next available year, 3/14. NHA has a gain of $15.6m in 3/13, but the federal taxable income for the group is only $2.8m, so the $24.89m loss available is limited to a ($2.8m) carryback. The remaining ($22.09m) for NHA should be carried into 3/14. When applying the remaining 3/15 capital loss into 3/14, NSI has a gain of $27.6m, but only a loss available of ($21.95m). NSI is limited to the ($21.95m) loss it has remaining. NHA has a gain of $59.3m, but only a remaining loss of ($22.09m), so it is limited to carry only ($22.09m). After these applications, the 3/15 capital loss is absorbed in full. Below is the application in table form:

Application of 3/15 losses:

	NSI	**NHA**	**Applied**
Loss available	(31.95)	(24.89)	
Apply to 3/12	10.00	-0-	10.00
	(21.95)	(24.89)	
Apply to 3/13	-0-	2.80	2.80
	(21.95)	(22.09)	
Apply to 3/14	21.95	22.09	44.04
	-0-	-0-	56.84

1. Application Of Capital Losses When Members Are Not Common

Another difficulty arises in the application of capital losses when members are not common in the loss and carry years.

The following example illustrates how this is handled:

EXAMPLE:

3/12	**3/13**	**3/14**	**3/15**
A 32M	A 6M	A 26M	A (33M)

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		B 1M C 3M	B 20M	B (23M)
Total Gain/Loss	32M	10M	46M	(56M)
C's Separate Loss				C (4M)
FTI	10M	20M	197M	

In this example, for 3/12, company A files separately, and companies B & C do not exist. For 3/13, A, B, and C file as one unitary group. For 3/14 and 3/15, A and B are one unitary group and C is a completely separate company. The A/B unitary group and separate company C both incur capital losses in 3/15.

The members of the group do not have to be common in the loss and carry years. To carry the capital loss, the same steps would be followed as shown in the section above. However, when it comes to step #4, carrying the loss into the unitary years, some additional considerations have to be made. There are still three limits:

- the amount of loss available for each company,
- the gain amount for each company in the carry year, and
- the total amount of federal taxable income for the group in the carry year, whichever is the smallest of these three.

First looking at the common members between the loss and carry year, apply enough of each member's own losses to offset total gains. Then looking at the members who filed separately in the loss year, but unitary in the carry year, apply their capital losses to offset their gains. After these applications, look at the limits from a group perspective. If the group limit has not yet been reached with the individual company amounts, and more gain is available to be offset up to the limit amount, the gain is offset by other members' losses on a pro-rata basis.

For the example, A will carry back ($10m) to offset its separate company income in 3/12. Neither B nor C existed in 3/12, so their first year available to carry is 3/13. The common members between the loss year and the carry year are A and B. ($6m) would be applied from the ($23m) remaining for company A. ($1m) would be applied from the ($23m) available for company B. The separate company is C, and ($3m) would be applied from C's total ($4m) capital loss. The total federal taxable income is $20m, and the total amount of loss available for the group is ($50m) ($33m from A + $23m from B + $4m from C - $10m offset by A to 3/12), so the smallest limit is the $10m capital gain amount. The limit is met by the loss applications on an individual basis. After this application to 3/13, ($17m) capital loss would remain available to carry into 3/14 for A, ($22m) for B and ($1m) for C.

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To illustrate the pro-rata offset by other members, following are three additional scenarios:

Scenario 1
Assume the information above remains the same, except that company C had a loss of only ($2m) in 3/15. All the steps in the previous paragraph would be the same, except C would only be able to offset $2m of the $3m gain, leaving $1m which has not been offset. If we look at the limit amounts from a group perspective, the smallest of the three limits is the $10m group capital gain amount, and only $9m has been offset ($6m from A, $1m from B, and $2m from C) so far. An additional $1m offset would be made on a pro-rata basis from the other loss companies. (33/56 x $1m = $590,000 from company A, and 23/56 x $1m = $410,000 from company B).

Scenario 2
Assume that the information remains the same, except that company C has a gain instead of a loss in 3/15. Thus, C would not have any loss to offset against its 3/13 gain. Company A would offset its $6m gain and company B would offset its $1m gain in 3/13. Since the group limit is still the $10m capital gain, and only $7m has been offset on an individual basis, A and B would carry additional loss back to offset the $3m from C. (33/56 x $3m = $1,770,000 from A and 23/56 x $3m = $1,230,000 from B).

Scenario 3
Assume that the information remains the same, except that companies A and B have gains rather than losses in 3/15. Only C would have loss available to carry back. The entire ($4m) loss from C for 3/15 would be carried back to offset the group's gain in 3/13.

D. Capital Losses & NOL'S Carried to Same Year

Since both capital losses and net operating losses may be carried back and forward, there could be situations in which both types of losses are carried to the same year. Whether there is a federal net operating loss involved or an Illinois net loss involved, the following paragraphs will apply.

The capital loss even if it is not the earliest year's loss must be carried first since it is an adjustment to federal taxable income.

EXAMPLE:

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Company A incurs a federal NOL in 2005, has an INL in 2006 and incurs a capital loss that cannot be absorbed by capital gains in 2008. None of these losses can be used in years prior to 2005 and there are no capital gains in 2005 and 2006 which can offset the capital loss. The 2008 capital loss would be applied to the 2007 capital gain. The FNOL from 2005 would be carried to 2007 and 2008. Illinois net income would be determined for 2008 and the 2006 INL would be carried.

	12/31/2005	12/31/2006	12/31/2007	12/31/2008
FTI (Loss)	(100,000)	(100,000)	100,000	200,000
Capital Gain (Loss)			15,000	(10,000)
C/B 2008 Cap Loss			(10,000)	10,000
FTI/(Loss)	(100,000)	(100,000)	90,000	200,000
C/F 2005 NOL	100,000		(90,000)	(10,000)
Remaining Inc(loss)	-0-	(100,000)	-0-	190,000
Apportionment		.90	.80	.75
IL Net Inc/(loss)		(90,000)		142,500
C/F 2006 I NL		90,000		(90,000)
Income after Loss		-0-		52,500

If an RAR is finalized, the losses would be reapplied after the adjustments for the RAR as follows:

	12/31/2005	12/31/2006	12/31/2007	12/31/2008
FTI (Loss)	(100,000)	(100,000)	100,000	200,000
RAR Change		25,000	10,000	50,000
Capital Gain (Loss)			15,000	(5,000)
C/B 2008 Cap Loss			(5,000)	5,000
FTI/(Loss)	(100,000)	(75,000)	105,000	250,000
C/F 2005 NOL	100,000		(100,000)	
Remaining Inc(loss)	-0-	(75,000)	5,000	250,000
Apportionment		.90	.80	.75
IL Net Inc/(loss)		(67,500)	4,000	187,500
C/F 2006 I NL		67,500	(4,000)	(63,500)
Income after Loss		-0-	-0-	124,000

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A federal capital loss carryback is considered before an INL carryback from the same year, since the federal capital loss would offset the capital gain changing the amount of Illinois net income available to be offset by the INL carryback. REF: 86 IAC § 100.2300(c).

A federal capital loss carryback may not increase or produce a federal net operating loss under IRC § 1212(a)(1)(A)(ii). However, it is possible that the capital loss carryback could create an INL in the carryback year.

E. Nonbusiness Income for Capital Gains/Losses

Federal income tax law requires capital gains and losses to be matched against each other in a manner that affects the determination of base income. However, even though capital gains and losses are netted together prior to Illinois line one, it is necessary to make a business/nonbusiness income determination for each separate item of gain or loss. Each item of gain or loss must be allocated or apportioned according to its Illinois characterization, without regard to whether it is used to offset another item in the computation of federal taxable income and Illinois base income. (REF: 86 IAC § 100.3010)

The determination of the business/nonbusiness nature of each separate capital gain or loss must be made in the year it was incurred. See Audit Manual Chapter 26 for further information on business/nonbusiness determination. Once the determination has been made, the gain/loss will retain that characteristic as it flows through the Illinois return. In addition, losses retain their classification in the carry years. If there has been a nonbusiness determination for a capital loss, then for the carry year it would remain a nonbusiness loss. The same applies to a capital loss that is found to be a business loss. No "re-determination" is made in the carry years.

Even though we make a determination of business/nonbusiness for the capital gains/losses, in computing Illinois line one, we still offset the full amount of capital gains against any available capital losses, regardless of their classification. Each item of capital gain or loss (including capital losses that have been carried back/forward from another year) that has been classified as nonbusiness will be deducted from base income. Any Illinois nonbusiness capital gain/loss will then be allocated back.

Often, there will be situations when both business and nonbusiness gains and losses net to a capital loss in the capital loss year. The question then arises as to how much of the remaining capital loss is business and how much is nonbusiness. Following are three examples detailing the pro-ration method:

Example:

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In Year 2, Taxpayer (TP) has $300,000 taxable income that consists of the following items:

Ordinary income	$300,000
Capital gain (business)	$ 20,000
Capital loss (business)	$ 60,000
Capital loss (nonbusiness)	$ 40,000

Taxable income is $300,000 because of the limitation on capital losses as explained above. TP has a capital loss carryover of ($80,000). IITA § 301(c) provides for the allocation only of items "taken into account" in the computation of base income. We must figure out how much of TP's ($60,000) business capital loss and how much of its ($40,000) nonbusiness capital loss were "taken into account" in computing base income. This is when we must use the pro-rata method: 60/100 X 20 = 12; 40/100 X 20 = 8. The result is that TP has an ($8,000) nonbusiness loss in Year 2 that must be specifically allocated. TP's base income therefore consists of business income of $308,000 and a nonbusiness loss of ($8,000).

Next, assume TP has a $50,000 capital gain in Year 1 that TP offsets with the Year 2 capital loss carryback. By using the pro-rata method again, we can determine the business and nonbusiness portions of the carryback. Based on the same facts, the business income portion of the carryback would be calculated as follows: (60-12)/80 X 50 = 30. Likewise, the nonbusiness income portion would be calculated similarly: (40-8)/80 X 50 = 20.

Following is the impact on the Illinois returns for Year 1 and Year 2:

CAPITAL LOSS SCHEDULE	**Year 1**	**Year 2**		
	Gain	Gain	Loss(bus)	Loss(Nbus)
Capital Gain	50,000	20,000		
Capital loss (bus)			(60,000)	
Capital loss (nonbus)				(40,000)
Application of Cap Losses:				
Yr 2 to current yr Cap Gain		(20,000)	12,000	8,000
Remaining to carry		0	(48,000)	(32,000)
Yr 2 c/b to Yr 1	(50,000)		30,000	20,000
Remaining to carry	0		(18,000)	(12,000)

	Year 1	**Year 2**

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Illinois Return:		
IL Line 1	100,000	300,000
Modifications	0	0
Base Income	100,000	300,000
Less: Nonbus Inc./(loss)	(20,000)	(8,000)
Business Income	120,000	308,000
Apportionment	X 1.0	X 1.0
Business Inc. appor. to IL	120,000	308,000
Nonbusiness inc alloc to IL	(20,000)	(8,000)
Base inc. allocable to IL	100,000	300,000

Example:

In Year 2, TP has $500,000 taxable income that consists of the following items:

Ordinary income	$500,000
Capital gain (business)	$ 40,000
Capital gain (nonbusiness)	$ 10,000
Capital loss (business)	($ 70,000)
Capital loss (nonbusiness)	($ 30,000)

Taxable income is $500,000 because of the limitation on capital losses as explained above. TP has a capital loss carryover of ($50,000). IITA §301(c) provides for the allocation only of items "taken into account" in the computation of base income. We must figure out how much of TP's ($70,000) business capital loss and how much of its ($30,000) nonbusiness capital loss were "taken into account" in computing base income. This is when we must use the pro-rata method: 70/100 X 50 = 35; 30/100 X 50 = 15. The result is that TP has a ($15,000) nonbusiness loss in Year 2 that must be specifically allocated. TP's base income therefore consists of business income of $505,000 ($500,000 ordinary income, plus $40,000 capital gain, minus ($35,000) capital loss) plus $10,000 in nonbusiness capital gains and ($15,000) in nonbusiness capital losses which must be separately allocated.

Next, assume TP has an $80,000 capital gain in Year 1. TP is limited to the remaining ($50,000) capital loss carryback for Year 2. By using the pro-rata method again, we can determine the business and nonbusiness portions of the carryback. Based on the same facts, the business income would be calculated as follows: (70-35)/50 X 50 = 35. Likewise, the nonbusiness income would be calculated similarly: (30-15)/50 X 50 = 15.

Following is the impact on the Illinois returns for Year 1 and Year 2.

CAPITAL LOSS SCHEDULE	**Year 1**	**Year 2**

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	Gain(bus)	Gain(both)	Loss(bus)	Loss(Nbus)
Capital Gain (bus)	80,000	40,000		
Capital Gain (nonbus)		10,000		
Capital loss (bus)			(70,000)	
Capital loss (nonbus)				(30,000)
Application of Cap Losses:				
Yr 2 to current yr Cap Gain		(50,000)	35,000	15,000
Remaining to carry		0	(35,000)	(15,000)
Yr 2 c/b to Yr 1	(50,000)		35,000	15,000
Remaining to carry/offset	30,000	0	0	0

	Year 1	**Year 2**
Illinois Return:		
IL Line 1	100,000	500,000
Modifications	0	0
Base Income	100,000	500,000
Less: Nonbus Inc./(loss)	(15,000)	(5,000)
Business Income	115,000	505,000
Apportionment	X 1.0	X 1.0
Business Inc. appor. to IL	115,000	505,000
Nonbusiness inc alloc to IL	(15,000)	(5,000)
Base inc. allocable to IL	100,000	500,000

Example:

In Year 2, TP has $300,000 taxable income that consists of the following items:

Ordinary income	$300,000
Capital gain (business)	$ 20,000
Capital loss (business)	($ 60,000)
Capital loss (nonbusiness allocable to Illinois)	($ 30,000)
Capital loss (nonbusiness allocable to Indiana)	($ 10,000)

The amount of each capital loss taken into account is: 60/100 X 20 = 12; 30/100 X 20 = 6; 10/100 X 2 = 2. TP would have business income of $308,000; ($6,000) in nonbusiness

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capital loss allocable to Illinois and ($2,000) in nonbusiness capital loss allocable to Indiana.

Following is the impact on the Illinois return for Year 2.

CAPITAL LOSS SCHEDULE	Year 2			
	Gain (bus)	Loss(bus)	Loss(Nbus-IL)	Loss(Nbus-IN)
Capital Gain (bus)	20,000			
Capital loss (bus)		(60,000)		
Capital loss (nonbus - IL)			(30,000)	
Capital loss (nonbus - IN)				(10,000)
Application of Cap Losses:				
Yr 2 to current yr Cap Gain	(20,000)	12,000	6,000	2,000
Remaining to carry	0	(48,000)	(24,000)	(8,000)

	Year 2
Illinois Return:	
IL Line 1	300,000
Modifications	0
Base Income	300,000
Less: Nonbus Inc./(loss)	(8,000)
Business Income	308,000
Apportionment	X .90
Business Inc. appor. to IL	277,200
Nonbusiness inc alloc to IL	(6,000)
Base inc. allocable to IL	271,200

VII. DISCHARGE OF INDEBTEDNESS

Under federal law, if a business cannot repay a debt, the borrower must pay tax on the "discharge of indebtedness" income. Because the business's inability to pay the debt is almost always the result of losses that the business deducts and the discharge of the debt is also deductible by the lender, this rule is necessary to prevent the same economic loss from creating two deductions. When the business is bankrupt or insolvent, it is not required to pay tax on the income. Instead, the double deduction is eliminated by requiring the business to reduce its basis in assets, federal capital loss carryforwards and federal net operating loss (NOL) carryforwards. This is a fair solution, because no tax is payable unless the business

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recovers and has income in future years. Reductions in asset basis and capital loss carryforwards automatically flow through to the computation of base income for all taxpayers, and reductions in NOL carryforwards flow through to the base income computation for individuals. However, reductions in NOL carryforwards do not affect base income of non-individuals because Illinois has decoupled from federal NOL carryovers. Nevertheless, the Department has taken the position that taxpayers were required by federal law to similarly reduce their state tax attributes.

A. IITA § 207

IITA § 207(c) provides that a taxpayer required to reduce a federal NOL or federal NOL carryover under IRC § 108(b)(2)(A), on account of discharge of indebtedness income excluded from gross income under IRC § 108(a) with respect to a taxable year ending on or after December 31, 2008, must reduce its INL incurred in the year of the discharge or any INLs carried over to that year.

B. 86 IAC § 100.2310

86 IAC § 100.2310(c)(2) states that the amount of a taxpayer's federal attribute reduction allocable to Illinois is computed by multiplying the reduction to the taxpayer's federal NOL or federal NOL carryover by the ratio of the excluded discharge of indebtedness income that would have been allocated and apportioned to Illinois but for the exclusion over the total amount of excluded discharge of indebtedness income.

For example, assume a taxpayer's apportionment factor is 50%, and that the taxpayer is required under federal income tax law to reduce a federal NOL from ($100) to $0 because it has excluded discharge of indebtedness income. In this scenario, the taxpayer would be required to reduce any INL for the same taxable year by the lesser of $50 or the amount of the INL for the year.

The regulations make clear that any reduction required to be made to an INL depends on whether the taxpayer was required to reduce a federal NOL, while any reduction required to be made to an INL carryover depends on whether the taxpayer was required to reduce a federal NOL carryover. See 86 IAC § 100.2310(c)(5)(C).

For example, assume a taxpayer has an INL for the taxable year of discharge, but no INL carryovers to that taxable year. Assume further that for federal purposes the taxpayer has positive federal taxable income for the taxable year of discharge, but is required under IRC § 108(b) to reduce a federal NOL carryover to that taxable year. Under IITA § 207(c), no reduction is required to the taxpayer's INL because no reduction was made to a federal NOL for that taxable year, even though the taxpayer was required federally to reduce a federal NOL carryover to that taxable year.

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Discharge of indebtedness is reported in Step 5 on Line 36 of the 2010 (and subsequent) IL-1120. Instructions on the form indicate that taxpayers are required to attach a federal Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness, when reporting amounts on this line.

VIII. HISTORICAL EXTRACTS

A. Federal Net Operating Losses

Illinois Net Losses were created by PA 84-1042 which added IITA § 207 effective for tax years ending on or after December 31, 1986. IITA § 207 resulted in Illinois completely decoupling from recognition of federal net operating losses incurred for tax years ending December 31, 1986 and after. 86 IAC § 100.2050 along with sections 100.2300 through 100.2350 were adopted October 16, 1987, setting forth the rules for applying the statute.

In computing a federal net operating loss (FNOL), there are certain limitations that apply and changes to limitations that normally apply when a FNOL is not involved:

- Net capital losses cannot be used in the computation of a FNOL just as they cannot be used to reduce taxable income.

- Charitable contribution limitations apply. Charitable contributions are limited to 10% of taxable income (5% for years ending on or before December 31, 1981) computed in accordance with IRC § 170 and, for members of a unitary group, 26 CFR § 1.1502-24. See Chapter 24 for further discussion of the charitable contribution limitation.

- A net operating loss deduction (NOLD) is not allowed. A net operating loss deduction occurs when a FNOL is carried to another year.

- The dividends received deduction is not limited when a NOL occurs. (Normally, this deduction is limited to 85% of taxable income for dividends received or accrued prior to 1987 and 80% for dividends received or accrued in 1987. For years after 1987, the deduction is limited to 80% for dividends received from corporations owned at least 20% by the recipient or 70% for dividends received from less than 20% owned corporations. Ref: IRC § 243.)

EXAMPLE:

Gross Profit	$500,000
Dividends	150,000

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Gross Income	650,000
Expenses	625,000
Taxable income before special deductions (Line 28)	25,000
Minus: Ded. for div. Received (NOT LIMITED TO 85% OF 25,000) (Line 29(b))	127,500 (85% of $150,000)
Net Operating Loss	($102,500)

For more information regarding the computation of FNOLs, refer to IRC § 172.

B. Illinois Treatment of FNOL'S

For tax years ending prior to December 1, 1983, the Department did not allow line 1 of the Illinois return to be less than zero. If the taxpayer reported a FNOL on line 1, the loss could be used to offset the excess Illinois addition modifications over subtraction modifications in the loss year and also carry the same loss either back or forward and offset income in another year. This created a double benefit.

As a result of various decisions in the Madison Park Bank and Chicago Title and Trust court cases, effective December 1, 1983 and after, an amendment to IITA § 203(e)(1) allowed line 1 to be negative and reflect the current year's NOL. See Chapter 49 for synopsis of the court cases. However, it is restricted by IITA § 203(e)(1) to the current year's NOL, which is computed by taking federal line 28 (federal taxable income (loss) before NOL deduction and special deductions) minus federal line 29(b) (special deductions).

EXAMPLE:

Federal 1120:

	1983	1984
L28	(10,000)	(9,000)
L29a	(15,000)	
L29b	(5,000)	(4,000)
L30	(30,000)	(13,000)

Illinois 1120:

	1983	1984

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L1	(15,000)	(13,000)

Prior to 1983, the taxpayer could claim an NOLD on the federal return in a year in which there was an NOL. However, in 1983, the instructions to the federal return were changed to state that no NOLD is allowed in a year in which the taxpayer already has a loss. An NOL cannot reduce line 30 to less than zero. However, you may still see federal returns with an NOL and an NOLD as detailed in the above example.

1. Three Stages of Illinois Law Regarding Negative Line 1

The various cases and laws described in the preceding paragraphs can be summarized as follows:

a) FOR TYE ON OR AFTER 8/1/69 THROUGH TYE ON OR BEFORE 11/30/83:

- Federal taxable income (Line 1 of the IL-1120) can be reported as a negative amount in both the loss and carry year (result of Chicago Title court case).
- The federal net operating loss deduction must be decreased by the amount of excess Illinois addition modifications which were offset in the loss year by the federal net operating loss. This adjustment insures that double deductions (prohibited by IITA § 203(g)) do not occur.

b) FOR TYE ON OR AFTER 12/1/83 THROUGH TYE ON OR BEFORE 12/30/86:

- Federal taxable income (Line 1 of the IL-1120) can be a negative amount, but not in excess of the amount of the FNOL incurred in the current loss year only. (IITA § 203(e)(1))
- An addition modification must be claimed in the carry year for the amount of excess Illinois addition modifications (i.e. addition modifications less subtraction modifications) which were offset in the loss year by the FNOL. (IITA § 203(b)(2)(E))
  REF: PA 83-951

  For discussion of the NOL addition modification, please refer to Chapter 24.

c) FOR TYE ON OR AFTER 12/31/86:

- Federal taxable income reflected on Line 1 of the IL-1120 can be a negative amount in both the loss and carry year. (IITA § 203(e)(1))

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- Federal NOLD from losses occurring in tax years ending December 31, 1986 and after must be added back to base income. (IITA § 203(b)(2)(D)) This adjustment is made on a worksheet in the instructions for Form IL-1120 and results in the federal NOLD to simply be deleted from the calculation of federal taxable income.

- Federal NOLD's carried forward from tax years ending prior to December 31, 1986 may be applied to offset excess addition modifications in the carry year, to the extent the FNOL has not previously been used for Illinois purposes and to the extent that the adjustment does not create negative Illinois base income. (IITA § 203(e)(1)) This adjustment is claimed on Line 5g, Part I of Form IL-1120 and must be supported by Schedule NL-5g (Schedule UB/NL-5g, for unitary filers).

- The federal NOLD must be reduced by the amount of excess addition modifications which were offset in the loss year. (IITA § 203(b)(2)(E)) This adjustment is also claimed on Line 5g, Part I of Form IL-1120 and is supported by Schedule NL-5g (Schedule UB/NL-5g, for unitary filers).

Note: Schedules NL-5g and UB/NL-5g are included in the Illinois Package X until 2000 which is available in each district office. These forms are not available on the internet.

2. Unitary NOL Regulations

On April 24, 1984, regulations were enacted describing Illinois' treatment of federal NOLs and NOLDs. The regulations encompass 86 IAC § 100.2200 through 100.2250 and are retroactive to August 1, 1969. REF: 86 IAC § 100.2210(b)(1). The main points of these regulations follow.

a) Current NOLs Offset Current Income

The current NOLs of members will be used to offset the current income of the other group members. REF: 86 IAC § 100.2220. To the extent the current loss is offset by current income, no carryback or carryforward of that loss is allowed. REF: 86 IAC § 100.2230(a).

EXAMPLE:

CORPORATION A	200,000
CORPORATION B	300,000
CORPORATION C	500,000

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CORPORATION D	(150,000)
UNITARY INC	850,000

Corporation D's NOL for the year has been offset by the income of the other members of the unitary business group (UBG) and therefore, there is no NOL to be carried to another year.

b) Limitations 1 and 2

86 IAC § 100.2230(b) sets forth specific limitations to be applied to the amount of federal loss that the individual member can carryback or forward to any applicable year. These limitations are sometimes referred to as Limitation 1 and Limitation 2. Specifically, these regulations state that the individual member's losses that can be carried to another year are limited to the lesser of:

(1) The sum of the federal taxable income and NOLs in the year to which the loss is carried for the members that are the same in the loss year and the carry year (hereinafter referred to as the "common" members). OR

(2) The combined federal taxable income for the unitary group in the carryback or carryforward year.

EXAMPLE:

1983	**CO. A**	**CO. B**	**UBG**	
	(20,000)	(10,000)	(30,000)	
1984	**CO. A**	**CO. B**	**CO. C**	**UBG**
	10,000	5,000	1,000	16,000

Limitation 1 is 15,000.

Limitation 1 is computed using the income of Companies A and B in 1984 since they are the common members in the loss and carry year.

Company A	$10,000
Company B	5,000
Limitation 1	$15,000

Limitation 2 is 16,000, which is the income of the unitary business group in the carry year.

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In this example, Companies A and B will be allowed to carry forward 15,000 of the 1983 NOL (the lesser of limitations 1 and 2).

86 IAC § 100.2230(c) further explains the above limitations. This section includes an explanation of the application of limitation no. 1 for years in which a separate basis loss is incurred. In this circumstance, the amount to be carried is limited to the income of that separate member in the carry year (since this company would be the only common member in the year of the loss and in the carry year).

EXAMPLE:

1980	**Co. A**
NOL	(30,000)

1981	**Co. A**	**Co. B**	**Co. C**	**UBG**
FTI	l,000	15,000	30,000	46,000

Under 86 IAC § 100.2230(b) and (c), Company A is limited to a carryforward of $1,000. Limitation 1 for Company A is $1,000 - since A is the only common member in the loss and carry year. Limitation 2 is $46,000 - the income of the UBG for the carry year. Limitation 1 is the lesser of these limitations - therefore, $1,000 may be carried forward.

A pre-12/31/86 NOL carried to a post-12/30/86 combined Illinois return will be allowed to offset the total base income of common members (as limited by 86 IAC § 100.2230(b))

c) 100% Unitary Business Groups

For years ending prior to December 31, 1986, companies involved in a unitary business relationship were not allowed to file a unitary tax return if 100% of their operations were in Illinois. For years ending December 31, 1986 and after, this section was amended to remove this restriction and allow these same companies to file a unitary return. The Department has taken the position that the proper method of determining the limitations of carryback or carryforward losses of these members is to apply Limitation 1 of 86 IAC § 100.2230(b). Limitation 2 would also apply in carrying losses of 100% Illinois unitary business groups.

EXAMPLE:

Company A and Company B meet all the criteria for a unitary business group. The operations of both companies are conducted entirely within Illinois. For the

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year ended 12/31/85, both companies were restricted by IITA § 1501(a)(27) from filing unitary returns

YR	CO A	CO B	UBG
85	(1,000)	400	N/A
86	200	500	700

Companies A and B would be considered common members in the loss and income year. Limitation 1 and 2 would both be $700 with ($300) of the net operating loss remaining to be carried to a subsequent year. (The total amount of the loss allowed to be carried forward is not restricted - the entire ($1,000) NOL can be carried forward to applicable years.)

The above application will ONLY be made in those situations where the SOLE reason a unitary return could not be filed was because of the 100% Illinois filer restriction of then Section 1501(a)(27). In circumstances where the unitary determination is difficult due to incomplete records or insufficient data, the auditor should seek further guidance from the supervisor. In some cases, the determination for the current years may be used as a guideline to the determination of the loss years. If, for example, the auditor has determined that taxpayers do NOT compose a unitary group for the current period, the same criteria should be verified for the loss years and the proper limitations applied depending on the outcome of this research.

EXAMPLE:

Companies A, B and C were 100% Illinois filers and filed separate Illinois returns in 1985. None of the companies had a common parent and no one individual or entity controlled or owned more than 50% of the companies in 1985. In 1986, Company P acquired 80% control in each company and all four companies filed a combined Illinois return in 1986. The federal taxable income of each company in the applicable years was as follows:

1985 Separate		1986 UBG	
Company A	$10,000	Company A	$20,000
Company B	(15,000)	Company B	3,000
Company C	(20,000)	Company C	(1,000)
		Company P	5,000
		Total	$27,000

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Since Companies A, B and C would not have been eligible to file a unitary return in Illinois as a result of not meeting the common ownership requirement, limitations 1 AND 2 are applicable. Company B's carryforward would be ($3,000) of its 1985 net operating loss to 1986 under Limitation 1. Company C's carryforward would be zero in 1986 due to Limitation 1 since Company C incurred a net operating loss in 1986.

The application of the limitations stipulated by 86 IAC § 100.2230(b) are shown in the paragraphs that follow.

d) More Examples Of Limitation 1 And 2

(1) Same Unitary Group Members In Loss And Carry Year

Calculate the amount of the current NOL. (Current NOLs offset current income). Compare the members that are in the group in the loss year to the members that are in the group in the carry year. If these members are the same, the amount of loss carried is limited to the income of the unitary group in the carry year (Limitation 2).

1983	**CO. A**	**CO. B**	**CO. C**	**UBG TOTAL**
FTI	(20,000)	10,000	(5,000)	(15,000)
1984				
FTI	10,000	10,000	1,000	21,000
NOLD				(15,000)
REMAINING 1984 INCOME				6,000

The members (A, B & C) in the loss year (1983) are the same in the carry year (1984). The unitary business group in 1984 has sufficient income to totally offset the NOL carryforward.

(2) Unitary Group Members Different In Carry Year

1983	**CO. A**	**CO. B**	**CO. C**	**UBG TOTAL**
FTI	(20,000)	10,000	(5,000)	(15,000)
1984				
GRP 1	**CO. A**	**CO. D**		**UBG TOTAL**
FTI	2,000	8,000		10,000

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GRP 2	CO. B	CO. C	UBG TOTAL
FTI	4,000	2,000	6,000

The loss year members are not in the same unitary group in the carry year. Therefore, the loss must be prorated among the group members that incurred the loss as follows:

Companies A and C incurred the losses. These losses are added together.

Co. A	(20,000)
Co. C	(5,000)
TOTAL	(25,000)

Next, divide each company's individual loss by the total loss and multiply this percentage by the unitary group's loss:

Co. A (20,000)/(25,000) = 80% X (15,000) = (12,000)

Co. C (5,000)/(25,000) = 20% X (15,000) = (3,000)

Company A has a (12,000) NOL it can carry to another year and Company C has a (3,000) NOL to carry.

The two limitations should be applied to calculate the correct amount of NOL to be carried to each group. For Group 1 – Co. A is the common member. Limitation 1 is $2,000 and Limitation 2 is $10,000. Co. A can carry ($2,000) of its 1983 loss to offset Group 1's 1984 income. Co. A has ($10,000) of NOL remaining to carry to future years. The carryforward to 1984 for Group 1 would be:

GRP 1	CO. A	CO. D	UBG
FTI	2,000	8,000	10,000
NOLD	(2,000)		(2,000)
Remaining FTI	-0-	8,000	8,000

The carryforward for Group 2 would be calculated in the same way. Limitation 1 equals $6,000 (since B and C are common members in the loss and carry years) and Limitation 2 would equal $6,000 (the income of the unitary group in the carry year). Since there is only ($3,000) of NOL carryforward available and this amount is less than either limitation, the entire $3,000 can be carried to 1984.

GRP 2	CO. B	CO. C	UBG

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FTI	4,000	2,000	6,000
NOLD			(3,000)
Remaining FTI			3,000

(3) Unitary Group Members Different In Carry Year

Using the same facts as shown above except in 1984 Company E was added to Group 2 with a NOL of ($5,000) in 1984. The NOL carryforward would be calculated as follows:

1984

GRP 2	Co. B	Co. C	Co. E	UBG
FTI	4,000	2,000	(5,000)	1,000
NOLD				(1,000)
Remaining FTI				0

Group 2 is limited to a ($1,000) carryforward under limitation 2 - the group's income in the carry year of $1,000 is less than the combined income of the "common" members of $6,000. Company C would have ($2,000) of remaining NOL to carryforward.

(4) NOL with Newly Created Subsidiary

In a situation where a parent incurs a FNOL in a pre-12/31/86 tax year and in the carryforward year a wholly-owned subsidiary has been created, Limitation 1 will be applied based on the net income of the newly formed subsidiary and the parent corporation. This special rule does not apply to an acquired subsidiary.

Corporation A files a separate return for tax year end 12/31/85 and incurs a FNOL of ($1,000). On 1/1/86, Corporation A forms wholly-owned Subsidiary B. For the tax year end 12/31/86, Corporations A and B file a combined Illinois return reflecting (Illinois equivalent) federal taxable income of:

1985 Separate		1986 Combined	
Corp A	($1,000)	Corp A	$300
		Corp B	200
		Total	$500

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There are no addition or subtraction modifications on the Illinois return. ($500) of the pre-12/31/85 NOL will be allowed to carryforward and offset the total federal taxable income of Corporations A and B. The remaining ($500) is available to carryforward to the next year.

(5) Separate Filers Carrying Losses to Unitary Years

86 IAC § 100.2230(e)(5) discusses a formula to be used in situations where NOL's of two different filers are being carried to the same return. INSTEAD OF THE FORMULA SHOWN IN THE REGULATION, THE PRORATION SHOULD BE MADE BASED ON TAXPAYER'S LIMITATION 1 OR ACTUAL NOL, WHICHEVER IS LESS:

Corporation A incurred a ($1,000,000) NOL on its 1985 return.
Corporation B incurred a ($1,000,000) NOL on its 1985 return.
Each company filed a separate return in Illinois for 1985. In 1986, Corporations A, B and C file together as a unitary business group reflecting the following income:

1985 Separate		1986 Unitary	
Corp A	(1,000,000)	Corp A	$2,000,000
Corp B	(1,000,000)	Corp B	1,000,000
		Corp C	(1,000,000)
		UBG	$2,000,000

The 1985 federal NOL carryover (which is limited to ($2,000,000) by limitation 2) would be prorated between Corporations A and B based on the ratio of Limitation 1 for each corporation or the actual NOL whichever is less. In other words:

Corporation A $1,000,000/$2,000,000 = 50% X $2,000,000 = $1,000,000
Corporation B $1,000,000/$2,000,000 = 50% X $2,000,000 = $1,000,000

86 IAC § 100.2230(f)(3)(B)(iii) reflects a formula to be used in situations where the loss member's NOL being carried exceeds that member's taxable income in the carry year. This formula should only be relevant in those situations where the entire NOL being carried is less than the common member income (and the income of the entire UBG) in the carry year and a subsequent NOL is being carried to the same year. THE FORMULA SHOWN IN THE REGULATION'S EXAMPLE IS INCORRECT IN THAT IT MAY RESULT IN TOO MUCH LOSS BEING PRORATED TO ONE OR MORE COMMON MEMBER.

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EXAMPLE:

Loss Year, 1983:

Corporation A	(20,000)
Corporation B	30,000
Corporation C	5,000
Corporation D	(60,000)
Corporation G	5,000
Total UBG NOL	(40,000)

NOL Pro-Ration:
Corporation A 20,000/80,000 X (40,000) = (10,000)
Corporation D 60,000/80,000 X (40,000) = (30,000)

Carryback Year, 1980:

Corporation A	15,000 - 10,000 = 5,000
Corporation B	10,000
Corporation D	16,000 - 16,000 = -0-
Corporation F	20,000
Total UBG Inc	61,000

After the preliminary carryback of the loss member's prorated losses against their income in 1980, common members' (A,B & D) income remaining is 15,000 (A's income of 5,000 and B's income of 10,000). The remaining (14,000) of D's prorated loss will be divided between A and B using the following formula:

Common Member with remaining income
divided by
Total common member remaining income

Corporation A 5,000/15,000 X 14,000 = (4,667)
Corporation B 10,000/15,000 X 14,000 = (9,333)

Therefore, total 1983 NOL will be carried back as follows:

Corporation A	15,000 - 14,667 =	333
Corporation B	10,000 - 9,333 =	667
Corporation D	16,000 - 16,000 =	-0-
Corporation F	20,000 =	20,000

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Total 61,000 - 40,000 = 21,000

(6) Proration of Unitary NOL - Multiple Years And Groups

Proper proration of the net operating loss is important when the loss is being carried to multiple years and the group members change in the carry year.

EXAMPLE:

	Co. A	Co. B	Co. C	Co. D	Co. E	UBG
1983 FTI	(5,000)	(10,000)	(35,000)			(50,000)
1984 FTI	4,000	6,000				10,000
1984 FTI Separate			10,000			
1985 FTI						
Group 1	2,000			10,000		12,000
Group 2		3,000			1,000	4,000
Separate			10,000			

First, calculate each loss member's proportionate share of the 1983 loss under 86 IAC § 100.2230(b). Since all the members contributed to the loss in 1983, their proportionate share is as shown for their loss. In other words, A's share is (5,000), B's share is (10,000) and C's share is (35,000).

Next, compare the proportionate losses computed to limitations 1 and 2 for the common members of each of the groups in the carry year. Companies A and B are limited to a ($10,000) carryforward in 1984 based on both limitations. C will also be limited to a ($10,000) carryforward.

Next, determine the amount of the 1983 loss offset by each company in 1984 in order to compute the NOL available for carryforward to each company in 1985.

Under 86 IAC § 100.2230(e)(2)(B), the calculation is made by using the ratio "indicated by the relative amounts of their respective net operating losses originating" in 1983. In other words:

The common members in 1983 and 1984 are:

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Company A	(5,000)	5,000/15,000 = 33%
Company B	(10,000)	10,000/15,000 = 67%
	(15,000)	

Company A contributed 33% to the total loss sustained by Companies A and B; therefore, Company A is deemed to offset 33% of the applicable income (based on the limitations) in the carryforward year. Company B is deemed to have offset 67% of the income.

In 1984, the UBG made up of Companies A and B had 10,000 in income; therefore, Company A is able to carryforward (3,300) of its NOL into 1984 and Company B carries forward (6,700) of its NOL. Company C is able to carryforward (10,000) of its NOL.

1984:

Group I	**Co. A**	**Co. B**	**UBG**
FTI	4,000	6,000	10,000
NOLD	(3,300)	(6,700)	(10,000)
			-0-

1984

Separate	**Co. C**
FTI	10,000
NOLD	(10,000)
	-0-

Company A now has (1,700) NOL carryforward available (5,000- 3,300) and Company B has (3,300) NOL carryforward available (10,000 - 6,700). Company C has (25,000) NOL carryforward available (35,000 - 10,000).

1985:

Group 1	**Co. A**	**Co. D**	**UBG**
FTI	2,000	10,000	12,000
NOLD	(1,700)		(1,700)
	300	10,000	10,300

For Group 1 in 1985, Company A is the only common member in the loss and carry year. Company A has (1,700) NOL available for carryforward. This amount is lower than both limitations because limitation 1 would be Company A's income in 1985 which is 2,000 and the UBG's income (for limitation 2) is 12,000. Therefore, the entire NOL for Company A may be carried.

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1985:			
Group 2	**Co. B**	**Co. E**	**UBG**
FTI	3,000	1,000	4,000
NOLD	(3,000)		(3,000)
	-0-	-0-	1,000

Company B is the only common member of Group 2. Company B has a (3,300) NOL available for carryover, but limitation 1 (Company B's income in 1985) is 3,000 and limitation 2 (the income of the UBG for 1985) is 4,000. Therefore, Company B's NOL carryforward is limited to (3,000) under limitation 1 and Company B has (300) NOL available for carryforward to another year. Company C may again carryforward (10,000) and has (15,000) NOL remaining to carryforward to another year.

(7) Additional Examples

	Co. A	**Co. B**	**Co. C**	**Co. D**	**Co. E**	**UBG**
1983						
FTI	10m	10m	10m	(40m)		(10m)
1984						
FTI	(5m)	(5m)	(5m)	10m	10m	5m

As a result of Limitation 1, none of the 1983 NOL may be carried forward to 1984 since the net income/(loss) of the common members (Companies A, B, C, D) for 1984 is (5m). REF: 86 IAC § 100.2230(b)(1).

EXAMPE:

	Co. A	**Co. B**	**Co. C**	**Co. D**	**Co. E**	**Co. F**	**UBG**
1983							
FTI	30m	60m	70m	(150m)	(50m)		(40m)
1984							
FTI	6m			7m	7m	30m	50m

As a result of Limitation 1, the carryforward to 1984 is limited to (20m). The common members in the income and loss years are Companies A, D and E, and their net income in 1984 is 20m. REF: 86 IAC § 100.2230(b)(1).

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Company D and E's proportionate share of the 1983 NOL is calculated as follows:

D's NOL in 1983 + E's NOL in 1983:
150 + 50 = 200

Each loss member's NOL in 1983/Total loss members' NOLs in 1983:

D 150/200 = 75% X (40) = (30)
E 50/200 = 25% X (40) = (10)

This calculation shows that Company D is deemed to have provided 75% of the total loss incurred by the unitary group in 1983 and Company E is deemed to have provided 25% of the total loss. These percentages are then used to calculate each member's TOTAL proportionate share of the unitary group's loss in 1983. As shown, Company D's TOTAL proportionate share of the loss is (30m) and Company E's TOTAL proportionate share is (10m). This is the TOTAL amount of net operating loss each MEMBER may carry to another year.

REF: 86 IAC § 100.2230(b)s.

Proportionate share of carryforward loss:

D is deemed to have carried forward (15m) of its NOL:

75% X 20 = 15 (15 carryforward remaining)

E is deemed to have carried forward (5m) of its NOL:

25% X 20 = 5 (5 carryforward remaining)

When the amount of the loss carried to another year is less than the total loss available to be carried, a calculation must be made to determine the amount of loss carried to the income year by each loss member. The same percentages used to calculate the TOTAL proportionate share of the unitary loss in 1983 are used to calculate each loss member's portion of the loss carried forward to 1984. This calculation will be necessary in situations where a loss member leaves the group that incurred the loss. In this situation, the loss member's share of the unitary loss that has not already been carried to another year will continue with that member. If E were sold to Company X on January 1, 1985, E's (5m) NOL remaining

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would be available for carryforward against E's income in 1985. This (5m) would NOT be available for carryforward into the 1985 unitary group consisting of Companies A, D and F.

REF: 86 IAC § 100.2230(e)(2)(B).

EXAMPLE:

	Co. A	Co. B	Co. C	Co. V	Co. W	Co. X	Co. Y	UBG
1983								
Group 1	20	80	(150)					(50)
Group 2					20	80	(150)	(50)
1984								
FTI	10	10	15	(40)		15	30	40

Group 1 has a (50) NOL to carryforward and Group 2 has a (50) NOL to carryforward. First, determine Limitation 1 for the groups:

Group 1		**Group 2**	
Co. A	10	Co X	15
Co. B	10	Co. Y	30
Co. C	15		
	35		45

Limitation 1 = 35 + 45 = 80

REF: 86 IAC §§ 100.2230(d) and 100.2230(e)(4)

Limitation 2 is 40 (total income of the UBG in 1984); therefore the TOTAL carryforward (for BOTH groups 1 and 2) to 1984 is limited to 40.

The next step is to prorate the 40 between the two groups in order to determine the amount of the NOL used by each group. This proration is calculated using the percentage of income the common members of each group contributed to the income of the UBG in the carry year (as shown above in the computation of Limitation 1).

(Limitation 1 for Group 1 (or 2) / Total Limitation 1) X Limitation 2:

Company C - 35/80 X 40 = 17.50
Company Y - 45/80 X 40 = 22.50

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Of the (50) NOL from 1983, Company C has absorbed (17.50) in 1984 and has (32.50) (50.00 - 17.50) available for carryforward. Company Y has absorbed (22.50) in 1984 and has (27.50) (50.00 - 12.50) NOL available for carryforward.

REF: 86 IAC § 100.2230(e)(4).

e) Non-Unitary Loss or Carry Year

86 IAC § 100.2230(c) also includes an explanation of the application of Limitation 1 for years in which a separate basis loss is incurred. In this circumstance, the amount to be carried is limited to the income of that separate member in the carry year (since this company would be the only common member in the year of the loss and in the carry year). Refer to the Limitations 1 and 2 section for an example of this regulation and further explanation.

The carryback or forward of a loss member's proportionate share of the unitary group's loss to a nonunitary year is also handled in accordance with the limitations discussed in the Limitations 1 and 2 section. The fact that the unitary group included loss or income members that were not Illinois filers in the carry year will not have a bearing on the computation of the loss member's proportionate share of the loss or the amount of loss allowed to be carried.

	Co. A	**Co. B**	**UBG**
1985	(10,000)	8,000	(2,000)
1982	12,000		

Whether or not Company B is an Illinois filer is irrelevant in the above computation. Company A is the only loss member and as such has (2,000) of NOL that it will be allowed to carryback to 1982.

3. NOL Addition Modification - In General

As a result of negative Line 1 being allowed by the Department, the taxpayer could have offset excess Illinois addition modifications in the year the NOL occurs and offset Illinois income again in the year to which the loss is carried thereby creating a double deduction. A double deduction is not allowable under IITA § 203(g). IITA § 203(b)(2)(E) was written to counteract this problem. This modification is often called the NOL addition modification or the excess addition modification.

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Although this modification was not effective until December 1, 1983, its purpose is to guard against double deductions. Prior to December 1, 1983, the taxpayer would still not be allowed to offset Illinois income twice. In these prior years, a reduction may be made directly to the NOL allowed and the auditor's comments should reflect this adjustment as legislated by IITA § 203(g) regarding double deductions. REF: Madison Park Bank v. James B. Zagel, Illinois Appellate Court decision.

EXAMPLE:

Line 1	(10,000)
Add Modifications	8,000
Sub Modifications	2,000
Base Income	(4,000)

In this example, the (10,000) NOL is offsetting $6,000 in excess addition modifications over subtraction modifications.

Basically, IITA § 203(b)(2)(E) states:

> Taxable income may be less than zero (but not less than the NOL for the year) provided that when taxable income is less than zero, and addition modifications exceed subtraction modifications, an NOL addition modification must be made for any taxable year to which the NOL is applied.

In other words:

> **IF** taxable income is less than zero
> **AND** addition modifications are greater than subtraction modifications
> **THEN**: NOL addition modification in carry year.

This modification is limited under Sections 203(e)(2)(E)(i) and (ii) of the Act. Under subparagraph:

> (i), the total modification is reduced for any amount that has already been carried to another year.
>
> (ii), the NOL addition modification is never more than the amount of net operating loss carryback or carryforward .

In years with a NOL carryback or carryforward from more than one year, compute the modification for each loss year under the preceding rules and then add them together and this is the total modification for the year.

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a) Examples - NOL Addition Modification

The following are possible situations dealing with negative Line 1 and the offset of excess addition modifications.

EXAMPLE:

	As Filed by Taxpayer 1979 IL-1120		**As Accepted By IDOR 1979 IL-1120**
F1120 Line 30	(13,000)	IL-1120 Ln 1	0
Additions	20,000	Additions	20,000
Subtractions	7,000	Subtractions	7,000
Base Income	0	Base Income	13,000

	As Filed by Taxpayer 1976 IL-1120		**As Accepted By IDOR 1976 IL-1120**
F1120 Line 30	13,000	IL-1120 Ln 1	0
Additions	20,000	Additions	20,000
Subtractions	7,000	Subtractions	7,000
Base Income	26,000	Base Income	13,000

As originally filed by the taxpayer, the 1979 federal NOL offset 13,000 of excess addition modifications (addition minus subtraction modifications) in the year of the loss (1979) and then also offset 13,000 of income in the carryback year (1976). The Department's position would adjust Line 1 to zero in the loss year and thus guard against this type of double deduction occurring. Double deductions are expressly forbidden under IITA § 203(g).

The circumstances in this example show that the taxpayer has actually used the loss to offset income twice. Unfortunately, the Department's position was not imposed only in these circumstances. When a return was filed reflecting a negative amount on Line 1 of the Illinois return, this amount was automatically increased to zero. Many times this would result in a situation where a taxpayer never used the net operating loss to offset income because there was no income to offset the loss either in carryback or carryforward years. This was not a very favorable position among taxpayers.

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In the following examples, Line 28 of the federal Form 1120 represents taxable income before NOL deduction and special deductions. Line 29a represents the NOLD, Line 29b, special deductions and Line 30, taxable income. Line 3 of the IL-1120 reflects total addition modifications (other than the NOL addition modification), Line 6 reflects total subtraction modifications and Line 7 represents base income.

EXAMPLE:

	Federal 1120		IL-1120
Loss Year			
Line 28	(100)	Line 1 Income	(100)
Line 29a	-0-	Line 3 Additions	200
Line 29b	-0-	Line 6 Subtractions	50
Line 30	(100)	Line 7 Base Income	50
Carry Year			
Line 28	200	Line 1 Income	100
Line 29a	(100)	Line 3 Additions	130
Line 29b	-0-	NOL Add/Modification	100
Line 30	100	Line 6 Subtractions	80
		Line 7 Base Income	250

Taxpayer has incurred a (100) FNOL. In this loss year, addition modifications exceed subtraction modifications by 150. However, only 100 of Illinois income has been offset by the allowance of the negative Line 1; therefore, the NOL addition modification is 100 when the NOL is carried. Under the regulation, the NOL addition modification may not exceed the amount of NOL carried (and therefore, the NOL addition modification can never be greater than the total amount of the NOL). REF: IITA § 203(b)(2)(E)(ii).

EXAMPLE:

	Federal 1120		IL-1120
Loss Year			
Line 28	(100)	Line 1 Income	(100)
Line 29a	-0-	Line 3 Additions	50
Line 29b	-0-	Line 6 Subtractions	80
Line 30	(100)	Line 7 Base Income	(130)

Subtraction modifications are greater than the addition modifications in this example. Therefore, no NOL addition modification will be needed in the year to

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which the loss is carried as no Illinois income has been offset in the loss year. REF: IITA § 203(b)(2)(E).

EXAMPLE:

	Federal 1120		IL-1120
Loss Year			
Line 28	(200)	Line 1 Income	(200)
Line 29a	-0-	Line 3 Additions	300
Line 29b	-0-	Line 6 Subtractions	50
Line 30	(200)	Line 7 Base Income	50
Carry Year 1			
Line 28	150	Line 1 Income	-0-
Line 29a	(150)	Line 3 Additions	300
Line 29b	-0-	NOL Add/Modification	150
Line 30	-0-	Line 6 Subtractions	50
		Line 7 Base Income	400
Carry Year 2			
Line 28	100	Line 1 Income	50
Line 29a	(50)	Line 3 Additions	300
Line 29b	-0-	NOL Add/Modification	50
Line 30	50	Line 6 Subtractions	100
		Line 7 Base Income	300

Addition modifications exceed subtraction modifications by 250 in the loss year; however, under IITA § 203(e)(2)(E)(ii) the NOL addition modification is limited to the amount of the NOL carryback or carryforward. Since there is only (200) NOL in the loss year, the TOTAL NOL addition modification carried cannot exceed 200. This is reasonable since only 200 of Illinois income (i.e. the excess addition modifications) has been offset in the loss year as a result of negative Line 1.

In the first carry year, only (150) of the NOL can be carried; therefore, only 150 of the excess addition modifications will be added in this year. At this point, only (150) of the NOL reflected as a negative Line 1 in the loss year is being carried to another year to offset income, so only 150 of the modifications already offset need to be added back.

In the second carry year, the remaining (50) of NOL is absorbed. Under IITA § 203(e)(2)(E)(i), the original 200 NOL addition modification is reduced for the

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amount already carried to the first carry year (150), therefore, the NOL addition modification in the second year is 50.

Notice that the NOL addition modification is NOT prorated based on the amount of NOL being carried. This modification is a dollar for dollar adjustment. If the total excess addition modifications in the loss year are 500 and the total net operating loss is (5) million, and (500) of the NOL is carried to another year, the NOL addition modification in that year will be 500. The taxpayer has already had the advantage of offsetting 500 of Illinois income in the loss year; therefore, this entire amount must be added back before taxpayer is allowed to offset more Illinois income in the carry year.

EXAMPLE:

	Federal 1120		**IL-1120**
Loss Year			
Line 28	(200)	Line 1 Income	(200)
Line 29a	-0-	Line 3 Additions	300
Line 29b	-0-	Line 6 Subtractions	200
Line 30	(200)	Line 7 Base Income	(100)
Carry Year 1			
Line 28	100	Line 1 Income	-0-
Line 29a	(100)	Line 3 Additions	300
Line 29b	-0-	NOL Add/Modification	100
Line 30	-0-	Line 6 Subtractions	200
		Line 7 Base Income	200
Carry Year 2			
Line 28	100	Line 1 Income	-0-
Line 29a	(100)	Line 3 Additions	300
Line 29b	-0-	NOL Add/Modification	-0-
Line 30	-0-	Line 6 Subtractions	200
		Line 7 Base Income	100

In this example, the entire 100 NOL addition modification is added back in the first year to which (100) of NOL is carried. In the second carry year, (100) of NOL offsets federal taxable income and there is no NOL addition modification remaining to be added back.

b) Quick Reference Points

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The NOL addition modification is used to compensate for Illinois income offset by net operating losses. Therefore, if subtraction modifications exceed addition modifications, the net operating loss on Line 1 would have no effect on Illinois income and no NOL addition modification would be needed.

If the excess of addition over subtraction modifications exceeds the net operating loss, then that excess amount is already being taxed in the loss year and only the amount equaling the NOL needs to be recaptured in the carry year (or years).

If the NOL is never carried to another year, no NOL addition modification is necessary.

4. NOL Addition Modification - Unitary Filers

86 IAC § 100.2240 sets down rules for years (ending prior to December 31, 1986) in which unitary business groups incur net operating losses and the group's addition modifications exceed subtraction modifications in the loss years.

Each group member that carries a portion of the group's unitary FNOL to another year from a year in which that FNOL was used to offset the group's excess addition modifications, must take as an addition modification in the carry year, its respective share of the NOL addition modification.

Each loss member's respective share is determined in the same manner as its share of the combined FNOL was determined under 86 IAC § 100.2230(d).

The amount of the NOL addition modification required to be shown by each group member in the carry year is limited to the amount of loss actually carried to such year by the group member.

EXAMPLE:

Loss Year	**Co. A**	**Co. B**	**Co. C**	**Co. D**	**UBG**
Federal 1120					
Line 28	(20)	(5)	10		(15)
Line 29a					-0-
Line 29b					-0-
Line 30	(20)	(5)	10		(15)
IL-1120					
Line 1 Income	(20)	(5)	10		(15)

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Line 3 Additions			10	10
Line 6 Subtractions	(2)			(2)
Line 7 Base Income	(22)	(5)	20	(7)

	Co. A	Co. B	Co. C	Co. D	UBG
Carry Year					
Federal 1120					
Line 28	20	30	(15)	15	50
Line 29a	12	3			15
Line 29b					-0-
Line 30	8	27	(15)	15	35
IL-1120					
Line 1 Income	8	27	(15)	15	35
Line 3 Additions	5				5
NOL Add Modification	6	2			8
Line 6 Subtractions				(5)	(5)
Line 7 Base Income	19	29	(15)	10	43

The group's unitary federal net operating loss for the year is (15) which is divided between Companies A and B (the loss members) using the following formula:

(Individual Loss Member's NOL/Total Loss Members' NOLs) X UBG NOL

Company A's share: (20/25) X 15 = 12
Company B's share: (5/25) X 15 = 3

The same proration is used to compute each loss member's share of the excess NOL addition modification:

(Individual Loss Member's NOL/Total Loss Members' NOLs)
X UBG Excess Addition Modification

Company A's share: (20/25) X 8 = 6.4
Company B's share: (5/25) X 8 = 1.6

The NOL addition modification of unitary group loss members is determined based on the excess addition modifications of the entire group. The excess is the sum of C's addition modification less A's subtraction modification. The companies to which the modifications actually apply are irrelevant. If a company is a "loss member" and the

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unitary business group's addition modifications exceed subtraction modifications in the loss year, the "loss member" company will have a prorated portion of the NOL addition modification in the carry year.

EXAMPLE:

1983	**Co. A**	**Co. B**	**Co. C**	**Co. D**	**UBG**
Federal 1120					
Line 28	20	50	(24)	(96)	(50)
Line 29a					-0-
Line 29b					-0-
Line 30	20	50	(24)	(96)	(50)
IL-1120					
Line 1 Income	20	50	(24)	(96)	(50)
Line 3 Additions			90		90
Line 6 Subtractions				(20)	(20)
Line 7 Base Income	20	50	66	(116)	20

1984	**Co. A**	**Co. B**	**Co. C**	**Co. D**	**UBG**
Federal 1120					
Line 28	10	40	60	130	240
Line 29a			(10)	(40)	(50)
Line 29b					-0-
Line 30	10	40	50	90	190
IL-1120					
Line 1 Income	10	40	50	90	190
NOL Add Modification			10	40	50
NOL Deduction			(10)	(40)	(50)
Line 7 Base Income	10	40	50	90	190

The NOL carryforward amount is 50, since the "common" members are the same in the loss year and in the carry year. The proration of the individual loss member's loss is calculated based on the following formula:

(C's Loss)/(C+D's Losses) = Proration % for C:
24/120 = 20% (Corporation C)

(D's Loss)/(C+D's Losses) = Proration % for D:
96/120 = 80% (Corporation D)

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NOL proration per company:

Corporation C = (50) X 20% = (10)
Corporation D = (50) X 80% = (40)

The addition modifications exceed subtraction modifications by 70 but the NOL is only (50); therefore, the NOL addition modification will also be 50 and the proration of the NOL addition modification is based on the same percentage used for prorating the net operating loss.

5. FNOL Carried to 12/31/86 AND AFTER

The statute was also amended to allow Federal NOL's incurred prior to December 31, 1986 to offset excess addition modifications in a carryforward year ending on or after 12/31/86. REF: IITA § 203(e).

EXAMPLE:

	12/31/1985	12/31/1986
Federal 1120		
Line 28	(8,000)	4,000
Line 29a	-0-	(3,000)
Line 29b	(1,000)	(1,000)
Line 30	(9,000)	-0-
IL-1120		
Line 1 Income	(9,000)	-0-
Line 3 Additions	-0-	2,000
Line 6 Subtractions	-0-	-0-
NOL c/f Offset		(2,000)

For the year ended December 31, 1985, taxpayer has a (9,000) FNOL. For the year ended December 31, 1986, taxpayer may carryforward and offset (3,000) of the FNOL against federal taxable income (Line 28 less 29b). Taxpayer also has 2,000 of excess addition modifications in 1986. Under the regulations, taxpayer may use (2,000) of the 1985 NOL to offset this excess amount.

This change was an expansion of the rationale in Chicago Title and Trust. The taxpayer maintained that by allowing Line 1 of the Illinois return to be a negative amount only in the year in which the FNOL was incurred meant that Illinois tax was still being paid on Illinois modifications even though FNOL deduction was available. With this change to the statute, the taxpayer will not pay Illinois taxes on Illinois modifications when there is a pre-12/31/86 NOL carryforward available, and will not be

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double deducting any loss because the FNOL will be simultaneously reduced at the time of the offset.

A complete synopsis of Chicago Title and Trust is in Chapter 49.

In the above example, the taxpayer has offset (3,000) of the FNOL against federal taxable income, 2,000 against excess addition modifications and has (4,000) of FNOL remaining for carryforward for Illinois purposes. One very important limitation on this modification is that it may NOT create a negative base income. In other words, the carryforward of the pre-12/31/86 FNOL may not result in an Illinois net loss. (REF: IITA § 203(e)) This adjustment is made on Line 5g of the IL-1120. See the next section on Line 5g.

Excess addition modifications that were offset by pre-12/31/86 net operating losses must still modify Illinois income in the post-12/30/86 carry year. For the 1986 tax year, this excess is represented by the NOL addition modification on Line 2c of the IL-1120. For the 1987 tax year and after, this excess is incorporated into the calculation of the subtraction modification on Line 5g of the IL-1120. REF: Instructions to the IL-1120.

EXAMPLE:

	12/31/1985	12/31/1986
Federal 1120		
Line 28	(8,000)	4,000
Line 29a	-0-	(3,000)
Line 29b	(1,000)	(1,000)
Line 30	(9,000)	-0-
IL-1120		
Line 1 Income	(9,000)	-0-
Line 3 Additions	3,000	2,000
NOL Addition Mod		3,000
NOL c/f Offset	-0-	(5,000)
Line 7 Base Income	(6,000)	-0-

Taxpayer has incurred a (9,000) FNOL for the year ended December 31, 1985. The excess addition modifications being offset by negative Line 1 in this year are 3,000. In 1986, taxpayer carries the FNOL forward and offsets 3,000 in federal taxable income. Taxpayer has (6,000) of FNOL available for offset against Illinois modifications. The total NOL addition modification from December 31, 1985 is 3,000. If we add this amount to the 2,000 excess modifications in 1986, we see that taxpayer may carryforward (5,000) more of its 1985 FNOL into 1986. There remains (1,000) of 1985 FNOL for carryover.

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The FNOL addition modification is limited to the amount of the FNOL carryforward and the FNOL carryforwards from pre-12/31/86 tax years will also offset excess addition modifications in post-12/30/86 carry years. This means that the NOL addition modification will be the lesser of the total excess modifications offset in the loss year (net of any NOL addition modification already added back in prior carry years for such excess modifications) or the actual net operating loss used in the current carry year.

The limitations stated in 86 IAC § 100.2240(b) and (c) will still apply to all FNOL carryforwards. See the Section Limitations 1 and 2 in this chapter for an in depth discussion of these limitations.

6. Line 5G of the IL-1120

The various adjustments that had to be made to federal taxable income and Illinois base income as a result of FNOL kept growing, therefore in 1987, the Department consolidated these adjustments onto one line, or rather expanded the purpose of Line 5g in Part I of the IL-1120. This was not a change to the law, but rather a change to the form and instructions.

In 1986, Line 1 of the IL-1120 included the NOL deduction offset against federal taxable income. Line 2c reflected any applicable NOL addition modification and Line 5g reflected the amount of the NOLD which was offsetting the current year excess addition modifications.

7. Schedules NL and NL-5G

Schedule NL

Schedule NL (Schedule NL-1 for unitary filers) is used for tax years ending prior to December 31, 1987 to calculate the amount of the Federal net operating loss deduction allowable on the Illinois return (in other words for losses occurring prior to years ending December 31, 1986). This schedule is also used to calculate the applicable NOL addition modification.

The main points to remember about Schedule NL are:

(1) Line 4 in Part I is to reflect taxable income (Federal Line 28 less Line 29b) for the CARRY year; and
(2) Line 5 is to reflect the lesser of either the net operating loss remaining to be carried or the taxable income computed on Line 4.
The lesser amount is used because Line 1 in the carry year cannot be less than zero.

Part II of Schedule NL calculates the NOL addition modification.

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Lines 7 and 8 reflect the addition and subtraction modifications of the LOSS year.
Line 9 results in the entry of the lesser of the actual net operating loss for the loss year or the excess of the addition modifications over subtraction modifications (in the loss year).
Line 11 will reflect the lesser of the actual net operating loss deduction being taken in the carry year or the remaining excess addition modification.

In other words, the proper completion of this form will result in all applicable limitations being followed.

Schedule NL-5g
For tax years 1987 and up to 2001, all of the adjustments relating to pre-12/31/86 FNOL carryforwards are calculated on Schedule NL-5g (or Schedule UB/NL-5g for unitary filers) and the net is shown on Line 5g of Part I of the IL-1120. Schedule NL-5g is only to be used for losses arising from tax years ending PRIOR to December 31, 1986. Each column of the schedule represents a loss year and all three parts of the schedule should be completed for each loss year.

Part I determines the amount of FNOL remaining for carryforward to the current year. Taxpayer enters the entire FNOL on Line 1 (Line 28 of the F1120 less Line 29b). Line 2 removes any of the loss that has already been carried to another year. This amount includes any loss that has offset Illinois excess addition modifications in a December 31, 1986 or after carryforward year. See number 5, “FNOL carried to 12/31/86 and After,” in this section for an in depth discussion of this offset.

Part II of the schedule calculates any NOL addition modification applicable in the carryforward year (as mandated by IITA § 203(b)(2)(E)). This part MUST be completed if the taxpayer reported Line 1 of the IL-1120 as a negative amount in the loss year.

Lines 4 and 5 in Part II represent the addition and subtraction modifications (respectively) from the LOSS year.
Line 6 is merely the net of these two modifications.
Line 7 reduces the total NOL addition modification for any amount already carried to another year and
Line 8 reflects any remaining modification applicable.

Line 7 from Part II reduces Line 3 of Part I and the net amount is entered on Line 9 of Part III. Line 9 NL-5g reflects the total possible subtraction modification. The subtraction modification is limited in any given carry year to the total of Line 1 plus

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Line 2 less Lines 5a through 5f on the IL-1120. This limitation ensures that the taxpayer will not use unapportioned losses to create or increase a current year Illinois net loss. REF: IITA § 203(e).

Line 10 of the schedule represents the Illinois base income for the carryforward year before the Line 5g modification. This line relates to IITA § 203(e) which limits the pre-12/31/86 carryforward to an amount not to exceed the sum of the federal taxable income (before the net operating loss deduction), plus the excess of addition over subtraction modifications. If a taxpayer has a subtraction modification in the carryforward year that exceeds or equals federal taxable income and addition modifications (in other words, Line 10 is less than or equal to zero), no FNOL offset will be allowed in that carryforward year. To allow the FNOL offset in this circumstance would result in the creation of or increase to an Illinois net loss based purely on the fact that Illinois allowed a Federal net operating loss to be carried into the year.

Line 11 reflects the NOL offset allowed for the current year. The amount on this line is the lesser of Line 9 or 10 - the lesser of the actual NOL available for carryover (less the applicable NOL addition modification) or the Illinois base income before Line 5g modification. If either Line 9 or 10 is an amount less than or equal to zero, no NOL deduction will be allowed for that loss year.

If Line 10 is greater than Line 11, then there is base income remaining in the current year that is available for further offset by other NOL carryforwards. This net amount is reflected on Line 12 of the schedule. If Line 9 is greater than Line 11, then there is FNOL remaining from this loss year to be carried to another year. This amount is reflected on Line 13 of the schedule.

Schedule NL-5g will be used by separate apportionment filers and Schedule UB/NL-5g by unitary apportionment filers. These schedules replace former Schedules NL and NL-1.

8. <u>General Carryback and Carryforward Periods</u>

a) 12/31/1999 – 12/30/2003

For tax years ended on or after 12/31/99, all of the special federal carry back and carry forward provisions contained in IRC § 172 will not be followed on the Illinois return. This means that special losses such as bad debt losses for commercial banks, and specified liability losses cannot be carried back 10 years. They must be carried as was outlined in IITA § 207, back two years and forward twenty.

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b) Prior to 12/31/99

Federally, the carryback and carryforward periods for NOLs have changed numerous times since the inception of the deduction in 1918. Since the Illinois Income Tax Act was passed in 1969 up until the passing of Public Act 91-541 for tax years ended on or after December 31, 1999, Illinois generally followed the carry periods in IRC § 172. Following is a chart reflecting the general rule for the carry periods. These are used in most instances for both Federal NOL's prior to December 31, 1986 (when Illinois decoupled from Federal NOL's and created its own losses with PA 84-1042), and for Illinois NOL's from December 31, 1986 through December 31, 1999. Be aware, however, that certain taxpayers qualify for special carry periods during different time frames, or may elect to forego the carryback period all together. Refer to the chart of special carry periods found in the section titled SPECIAL CARRY BACK AND CARRY FORWARD PERIODS.

TAX PERIOD	CARRY BACK	CARRY FORWARD
1/1/58 – 12/31/75 *	3 YEARS	5 YEARS
1/1/76 – 8/5/97 **	3 YEARS	15 YEARS
8/6/97 – 12/31/99	2 YEARS	20 YEARS

* No election for this period to forego the carry back period

** For the tax years ended 1/1/76 – 12/31/81 the carry forward period was originally only seven years. However, PL 97-34 changed it to 15 years for any losses during this period that were still "alive" (able to be carried) in 1981.

In the application of the general rule, if a FNOL or IL NOL is carried back, it must be carried back to the earliest year of the carryback period. If it is not entirely offset by income in that year, it is carried to the next year of the carry back period and so on into the carryover period until the loss is absorbed or the carryover period expires.

EXAMPLE :

1983	1984	1985	1986
9,000	1,000	10,000	(10,000)

Company A has received a billing notice for 1985 stating that additional tax is due in that year. It would appear to be more advantageous for the company to carryback the 1986 FNOL to 1985 to offset the additional tax and not have to pay the tax out of pocket. However, this will not be allowed since 1983 is the third

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preceding year and the Company must offset its income with the FNOL in 1983 first. The remaining ($1,000) could then be carried to 1984. Once these proper carrybacks are made, no NOL remains to carry to 1985.

c) Special Situations For The General Rule

An auditor may encounter special situations that require exceptions in applying the general rule. Following are several of those situations and the method of handling them:

When a carry year is a loss year, a net operating loss deduction (NOLD) cannot be claimed in the same year that a NOL is incurred. However, the NOL year is still included in the total of years allowed for the carry forward period. Ref: IRC § 172(b).

When a taxpayer incurs a loss in its initial year of incorporation, there will be no carry back period. The applicable carry forward period should be utilized.

EXAMPLE :

	1986	**1987**	**1988**	**1989**
Federal L28	(10,000)	8,000	(4,000)	4,000
L29a(NOLD)		8,000		4,000
L29b (Div)			2,000	
Federal L30	(10,000)	-0-	(6,000)	-0-
IL L1	(10,000)	8,000	(6,000)	4,000
IL Modifications	1,000	(500)	0	1,000
Base Income	(9,000)	7,500	(6,000)	5,000
Apportionment	1.00	1.00	1.00	1.00
IL Base Income	(9,000)	7,500	(6,000)	5,000
IL NLD 86 to 87 & 89	9,000	(7,500)		(1,500)
IL NLD 88 to 89			3,500	(3,500)
Remaining Base Income/(Loss)	0	0	(2,500)	0

The Illinois Taxpayer was incorporated in 1986. Since the audit period of 1986 – 1989 falls during the period covered by Illinois NOL's, we must use the IL NOL rules rather than FNOL rules. Because the taxpayer was incorporated in 1986, there are no years available for a carryback. The normal fifteen-year carry forward period starts with 1987, and all Illinois income will be offset with the 1986 loss. However, the 1986 loss cannot be carried into 1988 since the taxpayer incurred a loss in that year. Despite the fact that the 1986 loss was not applied

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here, 1988 will be counted as the second year in the fifteen-year carryforward period for the 1986 loss. The remainder of the 1986 loss will be absorbed in 1989. The ($6,000) 1988 NOL cannot be carried back because there is no income remaining in the prior years. It must go forward to the first available year, which is 1989. After offsetting the remaining $3,500 income in 1989, ($2,500) loss remains available to carry forward from 1988.

If the taxpayer was not an Illinois filer in the carry back year for a FNOL, or had no Illinois liability in the carryback year, the FNOL must be carried back to the earliest year of the carry period if the taxpayer was in existence. An exception to this would be if a federal election were made to forego the carry back period.

EXAMPLE:

Corporation C incurs a FNOL for the year ended December 31, 1985. For Federal purposes, Corporation C carries the loss back to 1982. Corporation C did not have nexus in Illinois until 1984. However, no part of the 1985 NOL can be carried to the 1984 Illinois return until first being offset with the applicable federal taxable income for 1982 and 1983:

1982	**1983**	**1984**	**1985**
75,000	50,000	45,000	(100,000)

Corporation C must carry the loss back to 1982 and offset $75,000. The remaining ($25,000) FNOL from 1985 will offset half of the 1983 income. Since all of the loss is absorbed before 1984, none of the ($100,000) FNOL will be carried to the 1984 Illinois return. REF: *Bodine Electric Company v.Robert H. Allphin,* 81 Ill. 2d 502 (1980). Refer to Chapter 49 for a synopsis of this case.

If a corporation incurs a NOL, becomes inactive for a period of time, and subsequently resumes business, it may still be allowed to carry forward the NOL. For federal purposes, the carryforward would be allowed if the corporation remains in existence with "continuity of enterprise". Illinois will allow the carryover (for both pre-12/31/86, and 12/31/86 and after NOL), if continuity of enterprise can be shown. An example of continuity of enterprise would be where a corporation continued to pay required business taxes and license fees.

If a taxpayer has filed a short year return, each short year return is considered a tax year in itself. For example, Company ABC has filed returns for 12/31/95, 6/30/96, 12/31/96, and 12/31/97. The 12/31/98 return is a loss year. The loss must be carried back to the prior three years. Company ABC would be required to carry it back to 6/30/96, 12/31/96, and 12/31/97. No amount of the loss is

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allowed to be carried to the 12/31/95 return because the 6/30/96 short-period return is considered to be a year by itself.

If a taxpayer filed with an election to use specific accounting, Schedule SA must be attached to the Illinois return. Schedule SA specifically allocates income and expense items to the portion of the tax year, in which they were paid, incurred or accrued. Detailed accounting records must be maintained to support the computations, and estimates are not permitted.

The following information was taken from SECTIONS 100.2000 THROUGH 100.2500 of the Regulations, which have been repealed.

Taxpayers electing to account specifically for items entering into the computation of base income must attribute to each portion of taxpayer's taxable year, only those items earned, received, paid, incurred or accrued for that taxable year. Certain items that reduce the taxable income of a corporation for federal income tax purposes are permitted in certain circumstances to be carried over from one taxable year to another such as:

1. Excess charitable contributions may be carried over pursuant to IRC Section 170(d)(2) subject, when appropriate, to the conditions and limitations of Section 381(c)(19);
2. Net operating losses may be carried over pursuant to Section 172(b) subject, when appropriate, to the conditions and limitations of Section 381(c)(1); and
3. Net capital losses may be carried over pursuant to Section 1212 subject, when appropriate, to the conditions and limitations of Section 381(c)(3).

Taxpayers making the election to use specific accounting must attribute the carryover items to the respective portions of their taxable year, exactly as though those respective portions were separate taxable years for federal income tax purposes. Also, the distributive shares of income from partnerships and Subchapter S corporations should be attributed exactly as though the respective portions of its taxable year were separate taxable years for federal income tax purposes. The distributive shares would be deemed received on the last day of the partnership's or Subchapter S corporation's tax year. REF: Sunshine Letter IT90-123.

Example:
Corporation A, a calendar year taxpayer, makes the election to specifically account for its income before and after June 30, 1984. In 1982, Corporation A made a charitable contribution, which exceeded the amount, deductible in that year pursuant to Section 170(d)(2) of the Internal Revenue Code. Under Section 170(d)(2), Corporation may, with certain limitations, use the excess contribution, until it is exhausted as a deduction, in the five succeeding taxable years.

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Therefore, Corporation A could potentially use its excess charitable contribution from 1982 in each of its tax years through and including 1987. Since A has elected to use specific accounting, the contribution carryover is first applied to its income for the period of January 1 through June 30, 1984 and then to its income for the period of July 1 through December 31, 1984.

If a taxpayer has made the election to account specifically for items entering into the computation of base income and thereafter files a claim for refund for a year for which the election was made and if that claim is premised on the following grounds:

1. The carryback of a net operating loss,
2. The carryback of a net capital loss, or
3. The reduction of the amount of partnership income previously reported as distributable to the taxpayer, then the claim for refund should be made consistent with the principle that the taxable year for which the election was made is, in effect, two separate years.

Example:

Corporation A, a calendar year corporation makes the election to use specific accounting to prorate its 1984 income. Corporation A sustains a net operating loss in 1985. Under Sections 172(b) and 6411 of the Internal Revenue Code, Corporation A makes an application for a tentative refund on the carryback of the 1985 net operating loss to its calendar years 1982, 1983 and 1984. Upon receiving that refund, Corporation A, within the applicable period of limitations, files claims for refund of Illinois income taxes for these years. While Corporation A is not precluded from filing a claim for refund of Illinois income tax paid for 1984, it is required, in calculating the amount of the refund, to apply the net operating loss available for 1984 against the two specific accounting periods, January 1, through June 30, 1984 and July 1 through December 31, 1984 as if they were separate taxable years.

9. Special Carryback and Carry Forward Periods
   Prior To 12/31/99

The 3 year carryback and 15 year carryforward for tax years ending on or before August 5, 1997 and the 2 year carryback and 20 year carryforward for tax years beginning after August 5, 1997 apply to most corporations. However, there are special rules for specific corporations or specific situations.

The following chart details the majority of the special carryback and carry forward periods found in IRC § 172. For further details about the losses, refer to IRC § 172. For tax years ended on or after 12/31/99, the Department decoupled from the special provisions found in IRC § 172. Consequently, on or after 12/31/99, these special periods are no longer in effect for Illinois purposes.

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Special Loss Type	Tax Period Ending	Federal Code Effective Dates	Carryback Period	Carryforward Period
Financial Institutions	1/1/76 – 12/31/86	1/1/76-12/31/86 (Defined in IRC 585, 586, 593) 1/1/87-12/31/90 (Defined in IRC 582(c)(5))	10 years 10 years	5 years 5 years
Bad Debt Losses for Commercial Banks per IRC 585(a)(2)	1/1/87 – 12/31/93	1/1/87 – present version of code	10 years	5 years
Bank For Cooperatives	1/1/70 – 12/31/86	1/1/70 – 12/31/90	10 years	5 years
Thrift Institutions per IRC 593	1/1/82 – 12/31/85	1/1/87 – 12/31/90	10 years	8 years
Federal National Mortgage Association	Exceeding Mortgage Disposition Loss: 1/1/82 – 12/31/86 Mortgage Disposition Loss: 1/1/82 – 12/31/86	1/1/82 – 12/31/90 1/1/82 – 12/31/90	10 years 3 years	5 years 15 years

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Federal Home Loan Mortgage Corporation	Exceeding Mortgage Disposition Loss: 1/1/85 – 12/31/86	1/1/85 – 12/31/90	10 years	5 years
	Mortgage Disposition Loss: 1/1/85 – 12/31/86	1/1/85 – 12/31/90	3 years	15 years
Statutory or Tort Liability Loss	1/1/84 – 12/31/90	1/1/84 – 12/31/90	10 years	15 years
Product Liability Loss	10/1/79 – 12/31/90	10/1/79 – 12/31/90	10 years	15 years
Specified Liability Loss	1/1/91 – 12/31/99	1/1/91 – 8/5/97	10 years	15 years
		8/6/97 – present version of code	10 years	20 years
Foreign Expropriation Loss	1/1/59 – 12/31/90	1/1/59 – 12/31/90	0 years	10 years
Cuban Expropriation Loss	1/1/59 – 12/31/90	1/1/89 – 10/3/76	0 years	15 years
		10/4/76 – 12/31/90	0 years	20 years
Regulated Transportation Corporation	1/1/56 – 12/31/75	1/1/56 – 8/15/93	3 years	7 years*
Real Estate Investment Trust (REIT)	10/5/76 – 12/31/99	10/5/76-8/5/97	0 years	15 years**
		8/6/97-present version of code	0 years	20 years
General Stock Ownership Corporation	Chartered between 1/1/79 – 1/1/84	1/1/79 – 10/22/86	0 years	10 years

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*NOTE: During the period 1/1/76 – 12/31/81 the carryback period for Regulated Transportation Corporations was increased to 9 years. PL 97-34 changed this back to 7 years for all losses that were still "alive" in 1981.

**NOTE: During the period 10/5/76 – 10/31/81, the carryforward period for REIT's was only 8 years. PL 97-34 increased this to 15 years for all losses that were still "alive" in 1981.

10. Election To Forego Carry Back Period

For tax years ended after 12/31/75, the IRS made a federal provision for relinquishing the carryback period and carrying the loss forward. To make the election federally, either a statement must be attached to the loss year return (for years prior to 12/31/92) or the election box must be checked on Schedule K of the federal 1120 (for years ended on or after 12/31/92). This election must be made by the due date of the loss year return including extensions to indicate the taxpayer's intentions to forego the carryback period. Once the election is made, the loss can only be carried forward and the taxpayer cannot change the election for that loss year. The election is made independently for each year in which a loss is incurred. Ref: IRC § 172(b)(3)(C).

EXAMPLE:

1983	1984	1985	1986	1987	1988
4,000	500	1,000	(10,000)	2,000	(3,000)

In this situation, taxpayer may elect to carryforward the 1986 FNOL because of complications that may occur if it was carried back to 1983 (perhaps the investment credits would be wiped out). Taxpayer decides that a carryback of the 1988 FNOL to 1985 would be beneficial. Taxpayer is allowed to make the carryback/carryforward decision independently for each year.

The passage of PL 94-455 created a unique problem for Illinois in regards to filers that were members of a federal consolidated return. Since federal consolidated members were required to re-compute their Illinois income as if they had filed a separate federal return, a consolidated member could reflect a FNOL when the consolidated group reflected income (and vice versa). It became unclear how the "election" to forego the carryback could be made for these consolidated filers. According to Public Act 80-588 and Income Tax Information Bulletin 1977-1, Illinois REQUIRED that FNOL's be carried forward as if the member of a federal consolidated return made the election to relinquish the carryback. They were not allowed to carry back their FNOL's for the period 9/12/77 through 12/31/86.

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Caterpillar Tractor Co. and Searle Pharmaceutical challenged this position taking their case before the Illinois Supreme Court. There, the Court ruled that the 1977 amendment by PA 80-588 was unconstitutional and in violation of the uniformity clause in the Illinois Constitution. Searle had argued that it was unconstitutional to treat taxpayers differently just because one taxpayer was a member of an affiliated corporate group that filed a consolidated federal return and the other taxpayer filed a separate federal return. The Court agreed with Searle when it determined that a "...classification must be based on a real and substantial difference between the people taxed and those not taxed, and that the classification must bear some reasonable relationship to the object of the legislation or the public policy." (See Chapter 49 for a synopsis of the Searle Pharmaceutical case.)

As a result of the Searle case, the following guidelines apply to what are termed **"pre-12/31/86" FNOLs**:

(1) Taxpayers that make a federal election must follow that election for Illinois purposes.

(2) Taxpayers that do not incur a NOL for federal purposes may make the election for Illinois purposes.

The Department took the position that the Supreme Court decision in Searle did NOT mean that taxpayers had to file amended returns to carryback losses that had already been carried forward. However, taxpayers still within the proper statutory period were allowed to file amended returns to change a carryforward to a carryback.

11. Statutes of Limitation - FNOL Carryback

For losses incurred prior to December 31, 1986, taxpayers had several separate statutory periods in which to file a claim for refund as a result of a carryback of a federal NOL. If ANY ONE of these statutory periods is open, the NOL may be carried.

The first two statutory periods are outlined in IITA § 911(a)(1).

First a taxpayer has the normal three-year statute for amending original returns for the year to which the loss is being carried.
Second, the taxpayer has one year from the date tax is paid to file a claim for refund of that tax. This refund would be restricted to the additional tax paid.

For example, if a taxpayer has a federal change increasing its federal taxable income and pays Illinois additional tax, that taxpayer would then have one year from paying that tax to file a claim carrying back a loss to offset this additional

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income. The amount of tax that will be refunded, however, cannot exceed the amount of tax paid within that last year.

The third statutory period can be found under IITA §§ 911(b)(1) and 506(b), and deals with federal changes.

A taxpayer may file a claim for refund within 2 years and 120 days of a federal change being agreed to or finally determined for federal purposes (2 years and 20 days for federal changes finalized prior to July 1, 1986).

86 IAC § 100.5030(b) details another situation derived from IITA § 506(b). It deals with a federal change to a separate Illinois filer who is a member of a federal consolidated return. If a separate Illinois filer incurred a NOL as a member of a federal consolidated return and in that consolidated return year the loss was partially or completely absorbed federally by income of other members of the affiliated group, then a special statute period applies. In this circumstance, the Illinois taxpayer with a pro forma loss has 3 years and 20 days after the last day of the loss year to file a claim for refund reflecting the carryback of the loss.

There are several unique situations which require special consideration in determining the statute. They are as follows:

The first situation deals with FNOL carrybacks and investment credits. If a federal NOL carryback would cause unused investment credit to be carried forward, generating a federal refund in a credit carryforward year (and not the NOL carryback year), the federal finalization for the NOL carryback year would be the date the federal refund is issued for the credit carryforward year. If the resulting credit carryforward does not result in a federal refund, the federal finalization for Illinois purposes is the date taxpayer filed the federal NOL carryback claim.

The second situation concerns the Searle Pharmaceutical court case. When the Supreme Court decision was made in 1987 for Searle Pharmaceutical, many companies had filed protective claims reflecting the carryback of their net operating losses. If these claims were filed within the appropriate statutory periods as previously discussed, refunds were made. However, many taxpayers felt that the decision should automatically open the statutes for them to file claims to carry back their losses, even though they had not filed timely claims. This was not the case. All claims had to have been filed within the appropriate statutory period; otherwise, the loss had to be carried forward. Taxpayers that had already carried forward a loss were allowed to carry back the loss (if the appropriate statutory periods were still open to file the claim) and amend the carryforward year, but they were not REQUIRED to carry the loss back. This was left to the taxpayer's discretion. REF: Information Bulletin FY88-1.

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If the statute was closed to amend a loss for the Searle Pharmaceutical decision, taxpayers were entitled to carry back the INCREASE to this FNOL resulting from a federal change. They would have the federal change statute of 2 years and 20 days designated by 86 IAC § 100.5030(b).

This rule would NOT apply to a federal change that increases an INL. In the situation of an INL, taxpayer making the election under 86 IAC § 100.2330(b) (to forego the carryback period), has made an irrevocable election for the taxable year. Therefore, any increase to the INL must also be carried forward.

The Department took the position that a carryback claim to the earliest carryback year would serve as a simultaneous protective claim for the other carry back years for statute of limitations purposes, to the extent that losses are not completely absorbed in the earliest year due to denial or partial denial by the Department.

EXAMPLE:

Corporation A timely filed an IL-1120-X to carry back a 1983 NOL to 1980. The 1983 NOL was the total of net income and losses of Corporation A and all of its subsidiaries. The 1983 NOL was completely absorbed in this amended filing. The group as filed was split into many smaller unitary groups in audit and the NOL carryback of each group to 1980 resulted in a portion of the 1983 NOL remaining for carryback to 1981. Under the Department's position, taxpayer would be allowed to carry the remaining portion of the 1983 NOL to 1981 even though a protective claim was not actually filed for 1981.

The final situation requiring special consideration is when a federal NOL is incurred or increased as a result of an Illinois audit. A signed IL-872 extending the statutory period for a loss year ending prior to December 31, 1986, does NOT extend the statutory period for filing the claim in the carryback year. The taxpayer must still be within the appropriate statutory period to receive a refund from carrying back the loss.

Refer to Chapter 21 for an in depth discussion of statutes and federal changes.

EXAMPLE:

	12/31/1986	12/31/1987
Federal 1120		
Line 28	3,000	3,000
Line 29a	-0-	(1,000)
Line 29b	(4,000)	(2,000)
Line 30	(1,000)	-0-

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IL-1120		
Line 1 Income	(1,000)	1,000
Apportionment	.50	.50
IL Net (Loss)/Income	(500)	500
Exemption	-0-	-0-

The (1,000) FNOL in 1986 has become an Illinois net loss (INL) of (500) in 1986. Under regulations, the (500) INL is carried forward to 1987 and offsets IL net income. For Federal purposes, taxpayer carries forward the (1,000) FNOL and offsets federal taxable income. For Illinois purposes, the specific instructions to the IL-1120 (for 1987 tax years and after) provide a worksheet for taxpayers to determine the amount to enter on Line 1 of the IL-1120. The worksheet results in all FNOL deductions being removed from the calculation of Line 1. A FNOL incurred in a year ending prior to December 31, 1986 will become part of the calculation allowed on Line 5g of the Illinois return. For more information on this issue, refer to the discussion of Line 5g of the IL-1120 in this chapter.

Once the calculation specified by the worksheet is made, taxpayer now reflects 1,000 of income on Line 1 of the IL-1120. This amount is apportioned to reflect 500 of Illinois income. The Illinois net loss deduction then offsets this Illinois income and results in -0- income for the year.

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INCOME AND REPLACEMENT TAX CREDITS

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I. PURPOSE

This chapter deals with the application of the various credits currently in effect. IITA §250, effective September 16, 1994 provides that all exemptions, credits, and deductions shall be limited by a reasonable and appropriate sunset date. If a reasonable and appropriate sunset date not specified in the Public Act, which creates the exemption, credit or deduction will automatically expire for tax years beginning on or after 5 years after the effective date of the PA's creation.

II. REFERENCE SOURCES

A. Illinois Income Tax Act

IITA § 250
IITA § 506(b)
IITA § 201(e)
IITA § 201(g)
IITA § 201(h)
IITA § 201(i)
IITA § 201(j)
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IITA § 223
IITA § 601(b)(3)

B. **Note:** Chapter 48 is a cumulative history of the Illinois Income Tax Act. Illinois Regulations

IAC § 100.2100
IAC § 100.2101
IAC § 100.2120
IAC § 100.2130
IAC § 100.2140
IAC § 100.2150
IAC § 100.2160
IAC § 100.2163
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IAC § 100.2170
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IAC § 100.2185
IAC § 100.2190
IAC § 100.2197
IAC § 100.5270(d)
IAC § 100.2171
IAC § 100.2193

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C. Illinois Statutes

20 ILCS 663 35 ILCS 25 35 ILCS 30

D. Department Forms

1299- Schedule B – River Edge Redevelopment Zone or Foreign Trade Zone subtraction (1120 or 1041)
1299- Schedule D - Income Tax Credits (1120, 1041, or 990T)
1299 – Schedule A – Tax Subtractions and Credits (1065 or 1120-ST)
1299 – Schedule C - Income Tax Subtractions and Credits (1040)
1299 – Schedule S (Enterprise Zones, Foreign Trade Zones, and Sub Zones)

III. REVENUE AGENTS REPORTS (RAR)

IITA § 506(b), added Illinois reporting requirements for federal changes which affect Article 2 credits. With this legislation, IITA § 506(b) states that changes to taxable income, any item of income or deduction, the income tax liability, or any tax credit which effect the computation of net income, net loss or any Article 2 credits are required to be reported within 120 days of the federal finalization date. This change in § 506(b) applies to any federal adjustments, which were finalized on or after January 1, 1998.

When reviewing Revenue Agents Reports (RAR), authority exists for the Department to recalculate the base period. The Auditor should look at the federal changes to the expenses and credits, which affect the Illinois credits and include them in the audit. If the federal audit is finalized prior to 1/1/1998, the federal changes to credits should be included if there is offset potential with other adjustments. After 1/1/1998, the RAR will open the statute to adjust the credits.

IV. REPLACEMENT TAX INVESTMENT CREDIT (RTIC)

IITA §201(e), IAC §100.2100, and §100.2101

Currently IITA § 201(e) states, in part, “A taxpayer shall be allowed a credit against the Personal Property Replacement Income tax for investment in qualified property (“the investment credit”).

- For tax years ending on or after January 1, 1994, the credit is available to any person who is subject to Replacement Tax and who is primarily engaged in manufacturing, retailing or mining of coal or fluorite. REF: IAC § 100.2101.

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- For tax years ending prior to January 1, 1994, this credit is available to any person who is subject to Replacement Tax and invested in qualified property used exclusively in manufacturing, retailing, or coal or fluorite mining.

The Replacement Tax credit is a two-part credit:

Part 1: Allowed a credit equal to .5% (.005) of the basis of qualified property placed in service during the taxable year, provided such property placed in service on or after: July 1, 1984. (IITA § 201(e) (1))

Part 2: An additional credit equal to .5% of the basis of qualified property placed in service during the taxable year, provided such property is placed in service on or after July 1, 1986, and the taxpayer's base employment in Illinois has increased by at least 1% (.001) over the preceding year.

- If, in any year, the increase in base employment within Illinois over the preceding year is less than 1%, the additional credit will be limited to one-half of the percentage of increase in the base employment. (IITA § 201(e) (1))

To claim the credit, a taxpayer must file Form IL-477 with their Illinois Income Tax Return.

A. PLACED IN SERVICE – ALL CREDIT YEARS

Properties placed in service the same taxable year in which used in determining the federal investment tax credit.

- "Placed in service" is defined as:
  - Condition or state of readiness; and
  - Available for a specifically assigned function.
    - REF: IRC § 1.46-3(d)(2)

Reasons for property not considered in computing the credit.

- disposed of;
- moved out of Illinois;
- ceases to be qualified for any reason during the same taxable year in which placed in service.

Note: For property, which is disposed of, moved out of Illinois or ceases to be qualified in subsequent years, please refer to the recapture requirements.

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B. BASIS (PART 1) – ALL CREDIT YEARS

- The basis of qualified property is the basis used to compute the depreciation deduction for Federal Income Tax purposes.
  - Basis used to compute depreciation does not include any amount for which an IRC §179 deduction was taken but does include amounts for which a bonus depreciation deduction was taken, including 100% bonus depreciation.

  - Any improvement or addition made is considered qualified property to the extent that it is of a capital nature.

  - If the basis of the property increases or decreases during the taxable year in which placed in service. The basis used for purposes of computing the credit is:

    - If the basis increases in a subsequent year, the increase in basis considered property placed in service on the date of such increase.

    - If the basis decreases in a subsequent year because of a redetermination of the purchase price, the recapture provisions of the credit will apply.

Example: if property is purchased and placed in service in a year and in a subsequent year. The vendor issues a refund to the taxpayer because of the reduction in the purchase price, the basis of that property has decreased, and recapture provisions would apply.

C. ADDITIONAL BASE EMPLOYEMENT CREDIT (PART 2) – ALL CREDIT YEARS

For purposes of calculating the additional investment credit, base employment in Illinois defined as:

- The average monthly total of individuals employed in Illinois by a taxpayer during the months of the taxable year in which the taxpayer was taxable in Illinois.

Therefore, to calculate base employment for a year, divide the total number of individuals employed in Illinois during each month of the taxable year (as reported to the Illinois Department of Employment Security on Form UC-3/40) by the number of months in the taxable year in which the taxpayer was in Illinois. REF: IITA § 201(e)(1).

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Example:

During calendar year 2010, Corporation X reported 600 employees for the first six months of the year and 750 employees for the last six months. Corporation X's base employment for 2010 was 675, computed as follows:

((600 x 6) + (750 x 6))/12 = 675.

In 2011, X reported 660 employees for the first six months and 696 for the next six months. Therefore, X's base employment for 2011 was 678, computed as follows:

((660 x 6) + (696 x 6))/12 = 678.

Corporation X's percentage of increase in 2011 base employment over 2010 is .44%. This is computed by subtracting the 2010 base employment from the 2011 base employment and dividing the remainder by the 2010 base employment, computed as follows:

(678-675)/675) = .0044 or .44%.

Corporation X will be allowed an additional investment credit of .22% (one-half of the percentage of the increase since the increase was less than 1%) times the adjusted basis of qualified property placed in service in Illinois during the taxable year. If the increase in base employment had been 1% or greater, the taxpayer would have been allowed the full additional .5% credit.

IITA § 201(e)(1) states that taxpayers that are new to Illinois would be deemed to have met the 1%-growth in employment for the first year in which they file employment records with the Illinois Department of Employment Security. The provision applies retroactively to 1986 if all other qualifications are met. REF: Sunshine letter IT90-0059.

D. DEFINITION OF QUALIFIED PROPERTY:

1. Tangible

   Buildings and structural components of buildings and signs are considered tangible property for purposes of the credit.

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- However, improvements to realty other than buildings and their structural components and signs do not meet tangible property for purposes of this credit, such as:

  - landscaping
  - sewer lines
  - local access road
  - fencing
  - parking lots
  - other appurtenances

<u>For tax years ending prior to January 1, 1994:</u>

- If a building used for both qualifying and non-qualifying operations, the cost needs apportioned. The apportioned cost is determined by multiplying the cost of the building by a fraction, the numerator of which is the total square footage devoted to qualifying operations and the denominator of which is the total square footage;

- When certain areas of the building used for both qualifying and non-qualifying operations (such as corridors, elevators, etc.), the square footage of these areas is eliminated from the numerator and denominator of the fraction. REF: IAC § 100.2100(f); Sunshine letter IT89-0301.

2. Depreciable Pursuant to IRC § 167

   (1) Provides a depreciation deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) of property which is used:
   - In the trade or business
   - Held to produce income

   (2) The property must have a useful life of four or more years as of the date placed in service.

   (3) Property depreciated under the Accelerated Cost Recovery System (ACRS) considered depreciable under the IRC.

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(4) Some examples of tangible property, which are not depreciable, are:
(a) Land,
(a) Inventories
(b) Stock in trade
(c) Natural resources

3. IRC § 179

(1) Allows taxpayers, under certain circumstances, to expense equipment purchased in a single tax year, which is ordinarily depreciated under IRC § 167.

(2) Commonly referred to as the "Section 179 Expensing Election", the amount expensed in each year shall not exceed the following amounts:

Tax Years Beginning In	Amount
1983 - 1987	$5,000
1988 - 1989	$7,500
1990 - 1992	$10,000
1993 - 1996	$17,500
1997	$18,000
1998	$18,500
1999	$19,000
2000	$20,000
2001 - 2002	$24,000
2003	$100,000
2004	$102,000
2005	$105,000
2006	$108,000
2007	$125,000
2008 – 2009	$250,000
2010 –2016	$500,000
2017	$510,000
2018 - 2019	$1,000,000

Property not fully expensed under IRC § 179 would qualify for the Illinois investment tax credit. The credits calculated based on the cost of the depreciable property reduced by the IRC § 179 deduction. REF: Sunshine letter IT88-0161.

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Note: For further information regarding the effective dates and the limitation amount of the IRC § 179 Expensing Election, refer to the appropriate sections of the IRC.

4. IRC § 168
   - The credit specifically excludes "3-year property"
   - Defined as' "Section 1245" class property with a present class life of 4 years or less. IRC § 168(c)(2)(A)
   - Used in connection with research and experimentation
   - January 1, 1986, automobiles and light trucks considered 5-year depreciable property. REF: Sunshine letter IT88-0166.

E. CATAGORIES OF ASSETS

IRS Revenue Procedure 87-56 lists the class lives of assets. The following considered "3-year property" and would not qualify for the credit:

1. ASSET CLASS 00.26 - Tractor units for use over-the-road.

2. ASSET CLASS 20.5 - Manufacture of Food and Beverages - Special Handling Devices. This class includes such items as returnable pallets, palletized containers and fish processing equipment including boxes, baskets, carts and flaking trays.

   Note: This class does not include general-purpose small tools, both hand and power-driven and other general-purpose equipment such as conveyors, transfer equipment and material handling devices.

3. ASSET CLASS 30.11 - Manufacture of Rubber Products - Special Tools and Devices. This class includes such assets as jigs, dies, mandrels, molds, lasts, patterns, specialty containers, pallets, shells, tire molds, and accessory parts such as rings and insert plates used in the production of products from natural, synthetic or reclaimed rubber, gutta percha, balata or gutta sika, such as:

   - Mechanical rubber goods;
   - Tubes;
   - Heels and soles;
   - Rubber footwear;
   - Flooring;
   - Rubber sundries; and
   - Tires, including also recapping, retreading and rebuilding.

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Note: This class does not include tire-building drums, accessory parts, general-purpose small tools and general-purpose equipment such as conveyors and transfer equipment.

4. ASSET CLASS 30.21 - Manufacture of Finished Plastic Products - Special Tools. This class covers special tools: which may include jigs, dies, fixtures, molds, patterns, gauges, specialty transfer, and shipping devices, used in the manufacture of plastic products and the molding of primary plastics for the trade excluding the manufacture of basic plastics materials and phonograph records.

5. ASSET CLASS 32.11 - Manufacture of Glass Products - Special Tools. This class covers special tools which may include molds, patterns, pallets and specialty transfer and shipping devices (such as steel racks to transport automotive glass) used in the production of flat, blown or pressed products of glass such as float and window glass, glass containers, glassware and fiberglass. This class does not include any special tools used in the manufacture of lenses.

6. ASSET CLASS 34.01 - Manufacture of Fabricated Metal Products - Special Tools. This class covers special tools which may include dies, jigs, molds, patterns, fixtures, gauges and returnable containers and drawings concerning such special tools used in the production of metal cans, tin ware, fabricated structural metal products, metal stampings and other ferrous and nonferrous metal and wire products not included in another asset class. This class does not include special tools used in the manufacture of non-electric heating apparatus.

7. ASSET CLASS 37.12 - Manufacture of Motor Vehicles - Special Tools. This class covers special tools which may include dies, jigs, molds, patterns, fixtures, gauges and specialty transfer and shipping devices, owned by manufacturers of finished motor vehicles and used in the manufacture and assembly of finished automobiles, trucks, trailers, motor homes and buses.

Note: the term "special tools" are tools specifically designed for the production or processing of particular parts. Have no significant utilitarian value and cannot be adapted to further or different use after changes or improvements are made in the model design of the particular part produced. It also does not include either hand or power-driven general-purpose tools or other general-purpose equipment such as conveyors, transfer equipment, and materials handling devices.

F. LEASEHOLD IMPROVEMENTS

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IRC § 1.167(a)-4, governs the determination of whether a leasehold improvement is depreciable. REF: Sunshine letter IT86-0100.

G. ACQUIRED BY PURCHASE

The property can be new or used, but cannot have been previously used in Illinois, in such a manner and by such a person as would qualify for the RTIC, or for the IITA § 201(f) Enterprise Zone Investment Credit.

1. IRC § 179(d) defines the term "acquired by purchase" as property, which the taxpayer: constructs, reconstructs or erects, itself is generally considered acquired by purchase. A purchase is defined as any acquisition of property but only if:

   a) The basis of the property in the hands of the person acquiring it is not determined:

      (1) In whole or in part by its adjusted basis in the hands of the person from whom the property was acquired; or

      (2) Under IRC § 1014(a), which applies to property acquired from a decedent. Therefore, property acquired by a bequest does not qualify as acquired by purchase.

   b) The property is not acquired from a person whose relationship to the acquiring person is such that it would result in the disallowance of losses under IRC § 267 or 707(b).

2. IRC § 267 – disallowed relationships are as follows:

   (a) Members of a family - The members of a family of an individual are limited to the individual's spouse, ancestors, and lineal descendants. IRC § 267(c)(4) defines "family" to also include brothers and sisters, but IRC § 179(d)(2)(A) provides that only spouses, ancestors and lineal descendants are treated as family for purposes of § 179. For example, if a husband and wife jointly purchase property from the husband's father, the property is treated as not acquired by purchase only to the extent of the husband's interest in the property. (Ref: CFR § 1.179-4(c)(ii));

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(b) An individual and a corporation of which the individual owns (or it is owned for him), either directly or indirectly, more than 50 percent of the value of the outstanding stock;

(c) Two or more corporations which are members of the same controlled group, as defined in IRC § 267(f)(1) (see below);

- A grantor and a fiduciary of the same trust;
- A fiduciary of a trust and a fiduciary of another trust if the same person is a grantor of both trusts;
- A fiduciary and a beneficiary of the same trust;
- A fiduciary of a trust and beneficiary of another trust, if the same person is a grantor of both trusts;
- A fiduciary of a trust and a corporation if more than 50% of the value of the outstanding stock of the corporation is owned, directly or indirectly by or for the trust or by or for a person who is a grantor of the trust;
- A person and an organization to which IRC § 501 (relating to certain educational and charitable organizations which are exempt from tax.) applies and which is controlled directly or indirectly by the person or, (if the person is an individual) by members of the family of the individual;
- A corporation and a partnership if the same person own:
    - More than 50% in value of the outstanding stock of the corporation, and more than 50% of the capital interest or the profits interest in the partnership;
- Two S Corporations if the same person(s) own(s) more than 50% in value of the outstanding stock of each corporation;
- An S corporation and C corporation, if the same person(s) own(s) more than 50 percent in value of the outstanding stock of each corporation; or

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- An executor of an estate and a beneficiary of such estate except in the case of a sale or exchange in satisfaction of a pecuniary bequest.

For purposes of IRC § 267, a controlled group has the same meaning as in IRC § 1563(a), except the stock ownership requirement is more than 50% (rather than 80%). The following discussion of IRC § 1563(a) has been adjusted accordingly.

IRC § 1563(a) lists the following four types of controlled groups:

1. Parent-Subsidiary - This type requires that one or more chains of corporations connected through stock ownership with a common parent if:

   a) More than 50% of the total of all outstanding voting stock or more than 50% of the total value of all shares of stock of each corporation, except the common parent, must be owned by one or more of the other corporations; and

   b) The common parent must directly own more than 50% of all outstanding voting stock (regardless of the class of stock) or more than 50% of the total value of all shares of stock of at least one of the other corporations.

2. Brother-Sister - This type of group involves two or more corporations, with five or fewer persons who are individuals, estates or trusts, who own stock possessing:

   a) More than 50% of the combined voting power of all classes of stock or more than 50% of the total value of all shares of stock (regardless of the class) of each corporation; and

   b) More than 50% of the total combined voting power of all classes of voting stock or more than 50% of the total value of all shares of all classes of stock of each corporation. This requirement limits the amount of stock, taken into account to that amount identically held for each corporation.

3. Combined Group - This type of group includes three or more corporations, each of which is a member of one of the two groups described above and one of which:

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a) Is a common parent corporation in a "parent-subsidiary" controlled group.

b) Included in a "brother-sister" controlled group.

c) Members of a combined return are allowed the credit, if all other requirements are met, when one member of the group purchases the property and another member uses the property.

4. Certain Insurance Companies – This fourth type of controlled group is one comprised only of life insurance companies, which IRC § 1563(a)(4) says cannot be combined with other types of business but instead must form a separate controlled group. IRC § 267(f)(1) states that § 1563(a)(4) does not apply.

a) As a rule, if a taxpayer is allowed a federal depreciation deduction on an asset, it is assumed that the asset was "acquired by purchase".

b) It should also appear on the federal Schedule L Balance Sheet.

(1) If the taxpayer is attempting to claim an investment credit on an asset that is not included on the federal Schedule L, nor has a depreciation expense been claimed for the asset. It is taxpayer's responsibility to prove that the asset was "acquired by purchase" per the above federal regulation sections.

Note: An exception to the above rule exists for assets, purchased from another member of the controlled group. The federal regulations define a member of a controlled group for "acquired by purchase" purposes as one, which owned or own more than 50% of the voting stock of another corporation. This is also true for Illinois purposes because the stock ownership requirement is more than 50% for membership in a unitary group.

3 IRC § 707 - disallowed relationships are:

a) A partnership and a person who owns, either directly or indirectly, more than 50% of the capital interest, or the profits interest in the partnership.

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b) Two partnerships, in which the same person owns, either directly or indirectly, more than 50% of the capital interest or profit interest,

H. QUALIFIYING USE

The property must be physically located in Illinois and used by the taxpayer claiming the credit. When determining whether the property is being "used in Illinois", the following needs taken into consideration:

Note: Mobile property - considered predominantly used in Illinois if its usage in Illinois exceeds its usage outside of Illinois. When calculating the percentage of time, the equipment is "used" in Illinois, storage time needs eliminated from both the numerator and denominator. Storage time includes indefinite storage and overnight parking of a loaded vehicle. REF: Sunshine Letter IT92-0083

FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1994

A taxpayer that is primarily engaged in manufacturing, retailing or in mining coal or fluorite must use the property; or property placed into service on or after 7/1/06 that is used in a River Edge Redevelopment Zone.

1. This determination is based on the primary occupation of the taxpayer, not on the specific use of the property. For example, if a taxpayer is determined primarily engaged in retailing, all property placed in service (if it meets the other qualifications for the credit) will be eligible for the credit, regardless of its specific use.

   a) An explanation of how to determine if a taxpayer is primarily engaged in manufacturing, retailing or mining of coal or fluorite can be found in the Section "Procedure for determining “primarily engaged”” below.

FOR TAX YEARS ENDING PRIOR TO JANUARY 1, 1994

The property must be used in Illinois by the taxpayer in manufacturing, retailing or mining coal or fluorite.

1. This determination is based on the specific use of the property, not the general occupation of the taxpayer. For example, the property does not qualify for the credit because the taxpayer is generally considered a retailer. The property itself must be used in a retailing activity.

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a) IAC § 100.2100(e)(7) states that the property must be used "exclusively" in manufacturing operations, retailing, coal mining, or fluorite mining. Incidental or de minimis use of a computer system in non-qualifying activities would not alone, disqualify the property for the credit. REF: Sunshine Letter IT91-0338.

I. PROCEDURE FOR DETERMINING "PRIMARILY ENGAGED"

A taxpayer considered to be primarily engaged in manufacturing, retailing or mining of coal or fluorite.

1. If over 50% of the taxpayer's gross receipts are from one or more of the qualifying activities.

   a) In the case of a combined group, the determination of eligibility shall be made for the combined group, rather than for any individual member.

2. To make that determination; the Auditor must perform the "Gross Receipts Test".

   a) Term "gross receipts" refers to gross receipts received by the taxpayer in the ordinary course of business.

   (1) Examples of gross receipts not received in the ordinary course of business would be a casualty loss or a sale of a fixed asset. If taxpayer suffers a casualty loss and compensated by insurance payment, the amount of money received will not be included in "gross receipts" received in the ordinary course of business. REF: IAC § 100.2101(f).

J. GROSS RECEIPTS TEST

Must be performed to determine if the taxpayer is engaged primarily (more than 50%) in a qualifying activity such as manufacturing, retailing, or in the mining of coal or fluorite (see note below on wholesalers).

1. To determine the percentage, we must divide the taxpayer's receipts from qualifying activity by the total receipts.

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a) If more than 50% of the taxpayer's gross receipts are from manufacturing, the taxpayer is primarily engaged in manufacturing. The same would apply for retailing and mining coal or fluorite. If a combination of manufacturing, retailing or mining coal or fluorite receipts total more than 50% of the gross receipts, a corporation is eligible for the credit.

2. The credit is limited to activities of Illinois taxpayers

a) Only included are the gross receipts of eligible members of the combined group (Illinois nexus companies) when performing the test on a unitary group.

b) In the case of a combined group, the denominator will be the total of the eligible members of the combined group's receipts and the numerator will be the total of the eligible member's receipts from qualifying activity. REF: IITA § 203(e)(2)(E). IAC § 100.5201 provides the definition of an eligible member of the combined group. IAC § 100.5270(d) defines the combined credits.

3. Gross receipts of corporations; which otherwise would be members of the combined group but have no nexus or which cannot be combined for another reason such as one factor with three factors, are not considered in this determination.

- To be consistent, all receipts from lines 1c plus sales tax, shipping and handling, labor, etc. and lines 5 through 10 of the U.S. 1120 will be used for the denominator except for items not received in the ordinary course of business.

- In determining the numerator for the gross receipts test, only receipts from the above lines received in the ordinary course of business from a **qualifying activity** will be used.

- Non-business income will be excluded from the calculation.

- In determining whether a combined group is primarily engaged in retailing. Gross receipts from transactions between eligible members of the combined group shall be eliminated from both the numerator and the denominator of the computation.

- In determining whether a combined group is primarily engaged in manufacturing or in the mining of coal or fluorite, gross receipts from these activities will include gross receipts from the sales of products

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manufactured, coal, or fluorite mined by one eligible member of the combined group to another eligible member. If including the gross receipts from the sales of products manufactured or coal or fluorite mined creates distortion, the amount can be adjusted under IITA § 404. REF: IAC § 100.5270(d)(3)

K. MANUFACTURING

Manufacturing operations are defined in IITA § 201(e) as the material staging and production of tangible personal property by procedures commonly regarded as manufacturing, processing, fabrication, or assembling which changes some existing material into new shapes, new qualities, or new combinations. (IAC § 100.2100(e)(8)).

- It is not necessary for the procedures to result in a finished consumer product.

Property used in the following activities **would** be considered being used in **manufacturing processes**:

- **Production machine testing equipment or quality control equipment** would generally qualify for the credit since used in operations, necessary to efficient manufacture of products that will meet quality standards.

- A process, which by the **introduction of chemical agents**, changing raw, non-drinkable water into purified, drinkable water.

- **Printing** has always been considered a manufacturing activity and therefore, any tangible property, which was used in the printing process, would have met this requirement of the credit. However, printing does not extend to activities considered Graphic Arts. See section below.

Property used in the following activities would generally **not** be considered being used in **manufacturing processes**:

- **Agricultural activities** including the raising and/or breeding of animals. Examples of agricultural activities would include cultivating the soil; raising or harvesting crops; producing seed or seedlings; and developing hybrid seeds, plants or shoots. Raising and/or breeding animals would include the raising and/or breeding of livestock, poultry, fish or any other animals, as well as commercial fishing or beekeeping. REF: Sunshine Letter IT95-0096;

- **Mining, quarrying, logging, drilling or any extractive process**.

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- **The construction, reconstruction, alteration, remodeling or improvement of real estate;**

- **Research and Development**. However, Illinois has a Research and Development Credit, discussed in a later section of this Chapter. Please refer to the Table of Contents;
- **Managerial activities** such as waste disposal, inventory control, production scheduling, work routing, purchasing, receiving, accounting, fiscal management, general communications, plant security, or personnel matters;

- **Office equipment, telephone systems, and vehicles** used by sales representatives making sales calls and/or trucks used for delivery of a finished product, are some examples of non-qualifying property. REF: Sunshine letter IT85-0327 and IT88-0249. Delivery trucks used in a retailing activity qualify for the credit.

    - **CAD/CAM** (computer assisted design/computer assisted manufacturing) systems - considered manufacturing activities only when system is integrated into the manufacturing operations. If the CAD/CAM system were used only for design purposes, it would not qualify for the Investment Credit

- **Graphic Arts** is considered a sale of service and is therefore not retailing or manufacturing. This includes taxpayers that provide digital imaging prepress services without doing the actual printing. See Schawk, Inc. v. Kenneth Zehnder, DOR, Cite 2001 WL 1480829 (ILL. App. 1 Dist), Docket 1-00-1872 (2001).

L. RETAILING

Retailing is defined in IITA § 201(e)(3) as the sale of tangible personal property or services rendered in conjunction with the sale of tangible consumer goods or commodities. IAC § 100.2101(e)(9) states that the tangible personal property must be finished consumer goods, and the property must be sold to its ultimate consumer. Sales of tangible personal property for resale are not included in the definition of retailing.

1. SERVICES PROVIDED WITH SALE

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a) Included in the definition of retailing, for purposes of this credit, are any services rendered in conjunction with the sale of tangible consumer goods or commodities such as uncrating, cleaning, assembling, delivery or installation, provided such services when are in conjunction with the retailing activities.

(1) Pursuant to Illinois, case law:

(a) Natural gas is tangible personal property. Therefore, sellers of natural gas <u>are</u> retailers and eligible for the credit.

(b) For decades, electricity was not considered tangible personal property. Exelon Corporation, parent of Illinois utility Commonwealth Edison, challenged that position, seeking millions of dollars for claims seeking the RTIC because the company was a retailer of electricity that should be considered tangible personal property.

The Illinois Supreme Court on February 20, 2009 issued its decision in *Exelon Corporation* reversing the Appellate Court and concluding that electricity is tangible personal property for purposes of the Corporate Income and Replacement Tax. In reaching, that conclusion the court not only reversed the lower courts' decisions but also 52 years of tax policy that assumed that electricity was an intangible.

For tax years ending after December 31, 2008, sellers of electricity do not qualify as retailers for purposes of the RTIC. REF: P.A. 96-115 (eff. July 31, 2009) REF: Keystone Consolidated v. Allphin, 45 Ill.App.3d 714 (1977) (Natural Gas), Farrand Coal v. Halpin, 10 Ill.2d 507 (1957), Exelon Corp. v. Dept. of Revenue (2009), 234 Ill.2d 266 (Electricity).

2. OFF-SITE WAREHOUSE, TRANSPORTATION AND OFFICE EQUIPMENT

a) The Department had taken the position that off-site warehouse; transportation and office equipment <u>was not</u> used either directly in the retail operation or in the performance of a service rendered in conjunction with a specific sale.

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(1) The Appellate Court allowed the equipment to qualify saying that the RTIC statute did not contain the “specific sale" requirement.

(a) The property was essential to the retailer's retail operations and without it the retailer could not conduct its sales of goods. REF: American Stores Company and Affiliates v. Illinois Department of Revenue.

Note: The Audit Bureau staff will follow the appellate court decision in American Stores. For tax years ending prior to 1/1/94, we will no longer rely upon the "specific sale" provisions of the regulations to disallow any warehouse, transportation or administrative property used in a retailer's business activities.

Since the decision involved only the definition of the term "retailing", it has no effect on the manufacturing or mining provisions of the credit. Only property used directly in the manufacturing or mining process qualifies during tax years ending prior to 1/1/94.

The other requirements that the property must meet to be "qualified" (i.e. acquired by purchase, depreciable, tangible, etc.) did not change nor did the recapture provisions.

The decision did not affect property used in service activities (as defined in the SOT regulations). For example, the equipment used in a pharmacy at a drug store will not qualify because it is a service activity rather than a retailing activity.

3. SALES OF CHEMICALLY TREATED WATER

a) The sale of chemically treated water by a privately-owned water treatment facility to a customer (i.e. a community) is also considered retailing.

4. ACTIVITIES NOT CONSIDERED “RETAILING”

The following are some additional examples of activities, which are **not** considered to be retailing activities:

- **Hotel or Motel Operations** - This only provides lodging facilities.
  - Hotels or motels which operate restaurants however would be allowed an Investment Credit on any property used in connection

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with those activities if the property met all the other necessary qualifications (i.e. depreciable, not 3-year property, etc.). REF: Sunshine letter IT87-0158;

- **Equipment** such as room furniture and fixtures, fire safety equipment, and rehabilitations to locker rooms.

- **Service Professions** - where the transfer of tangible personal property is only an incident to the service being performed are not retailers. For guidance in distinguishing service professions from retailing professions, see IAC § 140.101 et. Seq. (SOT Code) REF: IAC § 100.2100(e)(9)(C).

- **Renters or Lessors** of Tangible Personal Property - The renting or leasing of tangible personal property is not considered to be a service rendered in conjunction with a sale of tangible personal property which would not in any way qualify rental inventory for this credit. REF: Sunshine letter IT88-0141.

M. MINING

Mining (as defined in IRC § 613(c)) includes not only extraction, but also treatment processes such as cleaning, breaking, sorting, sizing, dust allaying, and loading for shipment. REF: IAC § 100.2101(e) (10).

- The operation of a gravel pit does not qualify for the credit since the credit is specifically limited to activities involved in the mining of coal or fluorite. REF: Sunshine Letter IT93-0119.

N. RIVER EDGE REDEVELOPMENT ZONE – EFFECTIVE ON OR AFTER JULY 1, 2006

The RTIC is allowed to any taxpayer placing qualified property in service on or after 7/1/06 in a River Edge Redevelopment Zone created by the River Edge Redevelopment Zone Act.

1. This allows an exception to the requirement that the taxpayer must be primarily engaged in manufacturing, retailing, or mining coal or fluorite.

   Currently, the only River Edge Redevelopment Zones are in Aurora, East St. Louis, Elgin, and Rockford.

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- For example, an accounting firm located in a River Edge Redevelopment Zone replaces its office computers and peripheral equipment. The RTIC could be claimed for the purchased equipment. REF: IITA § 201(e)(2)(D), IT 10-0007-GIL.

O. AGRICULTURAL CO-OPERATIVE ASSOCIATION

Prior to October 28, 1998, IAC § 130.1945(b)(2) could be read to hold that any equipment used by a seller of fertilizer and other farm chemicals in the spreading of such fertilizer and other farm chemicals was treated as being used exclusively in retailing. IAC § 130.1945(b)(2), as amended effective October 28, 1998, states that when Agricultural Co-operative Associations such as Farm Fertilizer Service Companies engage in selling services those receipts are subject to Service Occupation Tax. To avoid objection by JCAR, the Department agreed to apply this new regulation prospectively only.

Accordingly, for original returns filed on or after October 28, 1998, receipts from the spreading of such fertilizer and other farm chemicals will be considered sales of service for the gross receipts test. Companies with receipts from sales of service over 50% will not qualify for the credit.

P. REVISIONS FOR WHOLESALERS

On December 20, 2001, a revision was made to IAC § 100.5270(d)(3) that influences how the gross receipts test is calculated.

> **Note**: Paragraph B provides that sales made by a **wholesaler** of goods that it purchased from an eligible member of the combined group engaged in manufacturing or in coal/fluorite mining **would be** considered qualifying receipts. This provision was added to address a problem discovered by an auditor of a combined group that carried out its manufacturing business through several affiliated corporations, all of whom sold their output to a wholesaling affiliate. Because the wholesale affiliate resold the goods at a profit, its gross receipts exceeded the gross receipts from the manufacturing affiliates, disqualifying the group from the credit even though its only business was manufacturing. This new provision applies retroactively.

Q. EXAMPLES

Example 1 - Separate Company

Corporation A operates a hotel

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Total Gross Receipts = $100,000,000

$80,000,000	=	80%	Room rental
$15,000,000	=	15%	Restaurant and lounge operation
$ 5,000,000	=	5%	Gift shop operation

The renting of rooms is not considered retailing. Therefore, Corporation A is ineligible for the credit because it is not engaged primarily in retailing, even though it does engage in some retailing activities through the operation of the gift shop, restaurant and lounge.

Example 2 - Separate Return

Corporation B manufactures CD ROM Units for personal computers, which are sold to others for resale and sells canned software to end-users.

Total Gross Receipts = $100,000,000

$40,000,000	=	40%	retail sales of canned software
$40,000,000	=	40%	custom software development
$20,000,000	=	20%	manufacturing of CD ROM units

Corporation B is not engaged primarily in manufacturing and retailing, because sales of canned software are not sales of tangible personal property, even if the sales are subject to ROT under ROTA Section 2-25. That section overrules the holding in First National Bank of Springfield v. Dept. of Revenue, 85 Ill.2d 84 (1981), that computer software is not tangible personal property, but only does so for purposes of the ROTA. Accordingly, the total of its manufacturing and retailing operations is 20% of its gross receipts. Therefore, the Corporation is not eligible for the credit.

In determining whether a taxpayer is primarily engaged in an activity (Retailing, Manufacturing, etc.), the Department will consider the Gross Receipts of the taxpayer received in the ordinary course of business. If more than 50% of the taxpayer's gross receipts are from manufacturing, the taxpayer is primarily engaged in manufacturing. The same would apply for retailing and mining coal or fluorite. If a combination of Manufacturing, retailing or mining coal or fluorite receipts total more than 50% of the gross receipts, a corporation is eligible for the credit.

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Example 3 - Separate Unitary Returns

(T) = Total Receipts (Q) = Qualifying Receipts

Co. A(IL)	Co. B(NY)	Co. C(IL)	Co. D(IN)
$10,000,000 T	$10,000,000 T	$10,000,000 T	$10,000,000 T
$ 9,000,000 Q	$ 3,000,000 Q	$ 6,000,000 Q	$ 5,000,000 Q

Companies A and C filed separate Illinois returns on a unitary basis. In this case the gross receipts test is applied as if the taxpayers were not members of a unitary group. Both the numerator and denominator are computed on a separate basis.

Company A – $9,000,000 / $10,000,000 = 90%

Company C – $6,000,000 / $10,000,000 = 60%

Both companies qualify for the credit since the percentage of qualifying receipts is more than 50%.

Example 4 - Combined Return

Co. A(IL)	Co. B(IL)	Co. C(NY)	Co. D(IN)
$10,000,000 T	$10,000,000 T	$10,000,000 T	$70,000,000 T
$ 6,000,000 Q	$ 2,000,000 Q	$ 4,000,000 Q	$65,000,000 Q

Total receipts of eligible members A and B = $20,000,000
Total qualifying receipts of eligible members = $8,000,000

Company A - $6,000,000/$20,000,000 = 30%
Company B - $2,000,000/$20,000,000 = 10%

$8,000,000/$20,000,000 = 40%

The combined group will not qualify for the credit since the total percentage of qualifying operations is less than 50%. However, Company A would have qualified on its own had it not been a member of the combined return.

Example 5 - Combined Return

Co. A(IL)	Co. B(IL)	Co. C(NY)	Co. D(IN)
$15,000,000 T	$10,000,000 T	$10,000,000 T	$10,000,000 T
$13,750,000 Q	$ 0 Q	$ 3,000,000 Q	$ 8,000,000 Q

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Total receipts of eligible members A and B = $25,000,000
Total qualifying receipts of eligible members A and B = $13,750,000

Company A - $13,750,000/$25,000,000 = 55%
Company B - $0/$25,000,000 = 0%

$13,750,000/$25,000,000 = 55%

The combined group would qualify for the credit since the total percentage of qualifying operations is more than 50%. Company A would have qualified for the credit on its own had it not been unitary. Company B would not have qualified on its own had it not been unitary.

Example 6 - Combined Return

Co. A(IL)	Co. B(IL)	Co. C(IL)	Co. D(IN)
$10,000,000 T	$5,000,000 T	$20,000,000 T	$5,000,000 T
$ 6,000,000 Q	$3,000,000 Q	$ 8,000,000 Q	$ 0 Q

Total receipts of eligible members A, B and C = $35,000,000
Total qualifying receipts of eligible members = $17,000,000

Company A $6,000,000/$35,000,000 = 17%
Company B $3,000,000/$35,000,000 = 8.5%
Company C $8,000,000/$35,000,000 = 23%

$17,000,000/$35,000,000 = 48.5%

The combined group does not qualify for the credit since the total percentage of qualifying operations is less than 50%. However, Companies A and B would have qualified if they filed separate returns and Company C would not have qualified if separate.

Example 7 - Combined Return

Co. A (IL) (retailer)	Co. B (IL) (retailer)	Co. C (NY)	Co. D (IN)
$10,000,000 T	$20,000,000 T	$30,000,000 T	$70,000,000 T
$ 2,000,000 Q	$16,000,000 Q	$25,000,000 Q	$55,000,000 Q

Company A, a retailer, had $5,000,000 of intercompany sales to Company C. Company B had $10,000,000 intercompany sales to Company D. In doing the gross receipts test, intercompany sales are not eliminated if the sale is made to a

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non-qualifying member of the group. Although 100.5270(d)(3) allows for intercompany eliminations between "eligible members" that are retailers, Company C and Company D are not "eligible members" because they do not have Illinois nexus. However intercompany sales between Company A and Company B would be eliminated from both the numerator and denominator under 100.5270(d)(3) because they are retailers.

Total receipts of Illinois members A and B = $30,000,000
Total qualifying receipts of Illinois members = $18,000,000

Company A $2,000,000/$30,000,000 = 7%
Company B $16,000,000/$30,000,000 = 53%

$18,000,000/$30,000,000 = 60%

Both companies would qualify for the credit since the total percentage of qualifying operations is more than 50%. Company B would have qualified for the credit had it not been unitary, but Company A would not qualify had it not been unitary.

Example 8

The same facts as example #7 except for the fact that company A is a service company.

Both companies would qualify for the credit since the total percentage of qualifying operations is more than 50%. The fact that company A is a service company has no effect on the credit if the company is in the unitary group. If Company A was separate instead of unitary, it would not qualify for the credit since the qualifying receipts were less than 50%.

R. CHANGES IN UNITARY GROUP MEMBERS

IAC § 100.5270(d)(4) regarding a combined return state:

> "For purposes of determining the increase in employment in Illinois for a common taxable year, the Illinois employment of all taxpayers who are members of the combined group during that common taxable year shall be used; that is, both prior and current year Illinois employment of current members who were not members of the combined group in the prior year shall be included in the determination, while prior and current year Illinois employment of taxpayers who ceased to be members of the combined group during the current or prior year shall be excluded."

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- Therefore, the auditor will have to adjust the base period so that like members of the group are included.

  Example:

  Corporations A, B and C were members of a unitary business group which filed a combined return for 2001. Corporation D was not a member of the ABC combined group in 2001 but became a member of combined group ABCD filing a combined return for 2002.

  During 2001, Corporations A, B and C employed 150 people in Illinois and Corporation D employed 50 people in Illinois, for a total of 200. During 2002, Corporations A, B and C employed 100 people in Illinois and Corporation D employed 100 people in Illinois, again for a total of 200.

  IITA § 201(e), which provides for a Replacement Tax Investment Credit for qualified property placed in service by the taxpayer during the year, allows an additional 0.5% credit for such property to a taxpayer whose Illinois employment has increased by at least 1% over its Illinois employment in the immediately preceding year. Combined group ABCD cannot qualify for the additional 0.5% credit during 2002 because the combined Illinois employment of Corporations A, B, C and D remained unchanged between 2001 and 2002.

S. CURRENT POLICY ON PASS-THROUGH CREDITS

PA 91-913 amended § 201(e) effective for tax years ending on or after 12/31/2000, to state that:

1. Partnerships may no longer make the election to flow through their investment credits to their partners.

2. Investment credits earned by the partnership or the S corporation that are allocable to their partners or shareholders subject to replacement tax automatically flow through to those partners or shareholders.

   a) The new automatic pass through applies only to the RTIC earned during the taxable year and does not apply to carry forwards.

For tax years ending prior to 12/31/2000, IAC § 100.2101(h)(1) allows a partnership or S corporation to elect to pass the RTIC through to its partners or shareholders. The election to pass through the credit may be made by filing an amended return.

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- Once the election is made, it is irrevocable.

- The RTIC can only be carried forward 5 years from the year that it is earned. The auditor must verify when the entity earned the RTIC and how many years it carried the credit forward before passing it through to the partners.

T. CARRYOVER OF EXCESS CREDIT

The credit can never be used to decrease a taxpayer's liability below zero. Amendments were made to IITA § 201(e)(1) for tax years ending on or after December 31, 1987 to allow the carry-forward of any excess credit.

Any credit earned in a tax year after December 31, 1998, more than the Replacement Tax liability for the year in which the property was placed in service can be carried forward 5 taxable years following the year the credit was earned.

- The credit must be applied against the earliest carry-forward year for which there is a liability. If there is a credit from more than one tax year, the oldest credit will be applied first.

Any credits earned in tax years ending on or after December 31, 1987 and on or before December 31, 1988, a five-year carry-forward of any excess credit was only allowed if the taxpayer met all the following requirements:

- Located in an Enterprise Zone; and
  - Certified by DCCA (now DCEO, Department of Commerce and Economic Opportunity) as complying with the requirements set forth in a) and b) above by July 1, 1986. DCCA was required to notify the Department of all such certifications immediately.

Any person not meeting the above requirements of PA 84-165 would forfeit any investment credit more than the Replacement Tax liability for the same tax year.

Note: Diamond Star Motors Corporation was the only company that met the carry-forward criteria during that period. REF: PA 84-65 and 86-44.

U. RECAPTURE OF CREDIT – ALL CREDIT YEARS

Recapture is required and the Replacement Tax for such a taxable year shall be increased.

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1. Property ceases to be qualified if, within 48 months of placing it into service, the property is:

   a) Disposed of when:

      - Sold,
      - Exchanged or traded for new property,
      - Abandoned or retired from use.
      - Destroyed by casualty, stolen, or transferred as a gift
      - Transferred to a trustee in bankruptcy is considered disposed of in the year the property is transferred to the trustee. A transfer of property by foreclosure. REF: IAC § 100.2101(g)(2).

        Note: Mortgaged or used as security for a loan does not cease to qualify provided the taxpayer continues to use the property within Illinois.

   b) Moved outside of Illinois;

   c) Converted to personal use;

   d) For tax years ending on or after January 1, 1994, used by a taxpayer not primarily engaged in manufacturing, retailing or mining of coal or fluorite operations;

   e) For tax years ending prior to January 1, 1994, used in other than manufacturing, retailing, coal mining or fluorite mining activities;

   f) Reduced in basis. - The reduction of the basis of qualified property resulting from the redetermination of the purchase price is a disposition of qualified property to the extent of such reduction in the taxable year the reduction takes place. This occurs, for example, when property is purchased and placed in service in one year, and in a later year the taxpayer receives a refund of part of the original purchase price. See 26 CFR 1.47-2(c) (2010). REF: IAC § 100.2101(g)(3).

      - If the basis of the property is decreased, it will cause the replacement tax liability to be increased in the year that the basis decreased. To arrive at the correct investment tax credit allowable:

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(1) Recalculate the investment credit allowable based on the decreased value of the property; and

(2) Subtract the recalculated credit from the amount of credit previously allowed.

- The difference between the recalculated credit and the credit used is added to the Replacement Tax liability in the year the basis is reduced.

RECAPTURE ISSUES

1. If the asset qualified under the pre-1994 law and regulations, but after 1994 the taxpayer is not engaged in a qualifying activity, there is no recapture unless the asset was disposed of within the 48-month period.

2. If a taxpayer qualifies under the new law, for example, as a retailer, and then in a later year within the recapture period, ceases to qualify as a retailer, the credit is subject to recapture.

V. SALE AND LEASEBACK

A sale-leaseback is a disposition, which triggers the investment tax credit, recapture because the property ceases to be “qualified property” because it is no longer depreciable and no longer acquired by purchase, but by lease.

- Neither the lessor nor the lessee of property, which could properly be considered "qualified", can claim this credit. The lessor who owns the property is not using the property in a qualifying manner and the lessee who is using the property has not acquired the property by purchase. REF: Sunshine letters IT83-1013, IT85-0460, IT85-0690, IT85-0881

- The federal treatment of sale/leaseback transactions in the Internal Revenue Code is irrelevant because the language in the Illinois statute is distinctly different. REF: May Department Stores vs. IDOR, Cook County Circuit Court, Dkt 96 L 50934 (1999).

W. IRC 338(H) (10) ELECTION

IITA § 201(e)(7) requires recapture of investment credit where "any property ceases to be qualified property in the hands of the taxpayer within 48 months after being placed in service."

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- Under IITA § 201(e)(2)(E), property that has been previously used in Illinois in such a manner and by such a person as would qualify for the 201(e) credit is not "qualified property" for purposes of the investment credit. Accordingly, a new taxpayer may not claim the investment credit with respect to that property deemed purchased that qualified for the investment credit in the hands of old taxpayer.

- Where an IRC § 338(h) (10) election is made for tax purposes the assets are deemed transferred from one taxpayer to a different taxpayer. Accordingly, the property deemed sold ceases to be qualified property "*in the hands of the taxpayer*" for purposes of recapture under IITA § 201(e)(7). Thus, recapture is required.

- Where a qualifying purchase of stock is made, and the purchaser and seller elect under IRC § 338(h) (10), the subsidiary whose stock was purchased by the old taxpayer is deemed to have sold all its assets in a single transaction to a new corporation (new taxpayer).

- Old taxpayer is then deemed to liquidate. In most cases, old taxpayer's tax attributes are acquired by its parent in the deemed liquidation pursuant to IRC § 381. New taxpayer is a new corporation for income tax purposes.

V. ENTERPRISE ZONE AND RIVER EDGE REDEVELOPMENT ZONE INVESTMENT CREDIT

IITA §201(f) IAC §100.2110

IITA § 201(f) provides for an Enterprise Zone Investment Credit and a River Edge Redevelopment Zone Credit (for property placed in service on or after July 1, 2006) which is available to individuals, corporations, trusts and estates. It is a .5% credit computed based on qualified property in use in an Illinois Enterprise Zone, or qualified property placed into service in a River Edge Redevelopment Zone on or after July 1, 2006. The basis of qualified property is the basis used to compute the federal depreciation deduction.

For partners and shareholders of subchapter S corporations, there shall be allowed an enterprise zone or river edge redevelopment zone investment credit to be determined in accordance with the determination of income and distributive share of income under IRC § 702 and § 704 and subchapter S.

Schedules used to compute the Enterprise Zone/River Edge Redevelopment Zone credits are listed in the Reference Sources Section (II).

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A. RIVER EDGE – ADDITIONAL CREDIT FOR BASE EMPLOYMENT (INCREASE)

An additional credit of .5% of the basis of qualified property placed into a River Edge Redevelopment Zone on or after 7/1/06 is allowed where the Illinois base employment increased by 1% or more over the preceding year. If the base employment increases less than 1%, then the additional credit is the percentage increase multiplied by .5.

B. QUALIFIED PROPERTY

For purposes of this credit, to be qualified, the property:

1. Must be tangible (either new or used) including buildings and structural components of buildings;

Note: IITA § 201(f)(2)(A) does not have the provision contained in IITA § 201(e)(2)(a) stating that signs are qualified property, even if they would otherwise be considered real property. Accordingly, a sign might qualify for the RTIC but not for the enterprise zone credit.

2. Must be depreciable pursuant to IRC § 167 except that "3-year" property as defined in IRC §168(c)(2)(A) does not qualify;

3. Must be acquired by purchase per IRC § 179(d);

4. Must be used within an Enterprise Zone or River Edge Redevelopment Zone (after July 1, 2006) in Illinois by the taxpayer claiming the credit; and

   a) If an enterprise, which located in an enterprise zone, acquires adjacent property, which is outside the zone for expansion of its business activities, the new property will not be considered qualified for this credit since it is not placed in service within a zone. REF: Sunshine Letter IT93-0082.

   b) A lessor of otherwise qualified property, which it leases to another person for use in an enterprise zone can claim the Enterprise Zone Investment Credit on the leased property. REF: Sunshine letter IT86-0401.

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c) Storage of property is not considered use, as explained in IAC § 100.2110(e)(4)(A)(i):

- Storage of property in an enterprise zone or river edge redevelopment zone will not constitute use. The taxpayer must make use of, convert to its service, avail itself of, or employ the property in the enterprise zone or river edge redevelopment zone to demonstrate use of the property in the enterprise zone or river edge redevelopment zone.

5. Must not been used in Illinois previously in such a manner and by such a person as would have qualified it for the Replacement Tax Investment Credit or the Enterprise Zone and Rive Edge Redevelopment Zone Investment Credit, whether a credit had been taken for it. It will not, however, be disqualified if it was used before the time the credit came into effect.

- This possible limitation is for previously used property only. A taxpayer who purchases new property for use in an Enterprise Zone and which also qualifies for purposes of the Replacement Tax-Investment Credit can claim both credits in the same year. REF: Sunshine letter IT90-0205, 95-0133.

Note: Refer to Replacement Tax Investment Credit Section for a discussion of the terms "tangible property", "depreciable", "acquired by purchase", "3-year property" and "used in Illinois".

Verification of Qualified Property

It is the responsibility of the auditor to verify each business location is within an Enterprise or River Edge Redevelopment Zone. The auditor will first analyze the maps provided at the DCEO website:

https://www2.illinois.gov/dceo/expandrelocate/incentives/taxassistance/pages/ezmaps.aspx

If a determination cannot be made, auditors will submit the inquiry and documentation to their supervisor including:

- the exact street address,
- local business name and
- any additional information

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This information will then be:

- forwarded to the Technical Support Supervisor (TSS) for analysis,
- TSS will present to Audit Legal for review (if needed)
- IDOR's agency liaison will contact DCEO directly if needed
- final determination will be provided to the auditor by their supervisor

C. BASIS OF QUALIFIED PROPERTY

The basis of qualified property should be the basis used to compute the depreciation deduction for federal income tax purposes. Basis used to compute depreciation does not include any amount for which an IRC Section 179 deduction was taken but does include amounts for which a bonus depreciation deduction was taken, including 100% bonus depreciation. If the basis of the property for federal income tax depreciation increases after the property has been placed into service in an Enterprise or a River Edge Redevelopment Zone, the increase will be deemed property placed into service on the date of the increase in the federal basis. REF: IAC § 100.2110(f).

D. CARRYOVER OF EXCESS CREDIT

For tax years ending on or after December 31, 1985, if the amount of the credit exceeds the tax liability for the year, whether it exceeds the original liability, or the liability as later amended, such excess may be carried forward and applied to the tax liability of the five taxable years following the excess credit year.

- The credit applied to the earliest year for which there is a liability. If there is a credit from more than one tax year that is available to offset a liability, the oldest credit applied first.

- This credit cannot decrease a taxpayer's liability below zero.

E. RECAPTURE OF CREDIT

Recapture is required and the Income Tax for such a taxable year shall be increased, if during any taxable year, any property ceases to be qualified property in the hands of the taxpayer within 48 months after being placed in service. Any recapture of the credit is computed on Schedule 4255.

Property ceases to be qualified if, within 48 months of placing it into service, the property is:

- Disposed of (which means sold, exchanged, traded-in, abandoned, retired from use, destroyed by casualty, stolen, or transferred as a gift). Also,

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property transferred to a trustee in bankruptcy and property transferred by foreclosure are dispositions of property.

- Moved outside of an Illinois Enterprise or River Edge Redevelopment Zone for other than a temporary or transitory purpose.

- Converted to personal use.

- Sold in a sale-leaseback transaction or in a deemed asset sale under an IITA § 338(h) (10) election. See comments under the Recapture section for Replacement Tax Investment Credits.

- Reduced in basis. A reduction of the basis of qualified property resulting from a redetermination of the purchase price shall be deemed a disposition of qualified property to the extent of such reduction. For example, this would occur when property is purchased and placed into service in one year, and in a later year, the taxpayer receives a refund of a portion of the original purchase price.

    - If the basis of the property is decreased, it will cause the Income Tax liability to be increased in the year that the basis decreased. To arrive at the correct Income Tax investment credit allowable:

The amount of recapture is computed as follows:

- Recalculate the investment credit allowable excluding the basis of the property that has ceased to qualify or by using the decreased basis of the property.

- Subtract the recalculated credit from the amount of credit previously allowed.

The difference between the recalculated credit and the credit used is added to the Income Tax in the year the basis is reduced.

Example: In 2010, Corporation A places qualifying property with a basis of $55,000 into service in an Enterprise Zone or River Edge Redevelopment Zone located in Illinois and computes an IITA § 201(f) Enterprise Zone or River Edge Redevelopment Zone Investment Credit of $275 ($55,000 x .5%). Corporation A's 2010 income tax liability is $420. After the application of the credit, Corporation A has remaining income tax liability of $145. In the following year, Corporation A moved a qualifying asset having a basis in 2010 of $5,000 from the Enterprise Zone or River Edge Redevelopment Zone to another location in Illinois. As a result, Corporation A is required to recapture

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a portion of the Enterprise Zone or River Edge Redevelopment Zone Investment Credit that was applied against its 2010 income tax liability. To determine its additional income tax for 2011, Corporation A must recompute its 2010 Enterprise or River Edge credit by eliminating the disqualified property (($55,000 - $5,000) x .5%=$250). This recomputed credit is subtracted from the credit used in 2010 ($275 - $250= $25), and the difference is added to Corporation A's 2011 income tax after application of the Investment Tax Credit. REF: IAC § 100.2110(g)(3).

VI. JOBS TAX CREDIT – ENTERPRISE/RIVER EDGE REDEVELOPMENT/FOREIGN TRADE ZONE (SUB-ZONE)

IITA §201(g) IAC §100.2120

Note: Repealed by PA 98-109 on August 16, 2013.

The Jobs Tax Credit, as previously appeared in IITA § 201(g) provides for a $500 credit per eligible employee hired to work in an Illinois Enterprise Zone or River Edge Redevelopment Zone, or for a High Impact Business located in a federally designated Foreign Trade Zone or Sub-Zone.

The credit is based on employees hired on or after January 1, 1986 in an Enterprise Zone, after June 30, 1986 for employees hired to work in a Foreign Trade Zone or Sub-Zone, and on or after December 31 and can be used to offset an Illinois Income Tax liability. The credit is available to individuals, corporations, trusts and estates who meet the employment requirements of the IITA.

The credit was expanded for eligible workers hired in River Edge Redevelopment Zones for taxable years on or after December 31, 2006.

The Jobs Tax Credit is computed using:

- Schedule 1299-D for corporations and fiduciaries
- Schedule 1299-C for individuals.

Note: The Jobs Tax Credit does not pass-through to shareholders of Subchapter S corporations or partners of partnerships.

<u>For years ending on or after December 31, 1988</u>, the credit is allowed for the tax year immediately following the year in which the eligible employees are hired.

<u>For tax years ending on or after December 31, 1985 and prior to December 31, 1988</u>, the credit is allowed for the year in which the eligible employees are hired.

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A. QUALIFYING EMPLOYERS

To qualify for the credit:

1. The taxpayer must hire five or more "eligible" employees to work in an Enterprise Zone or River Edge Redevelopment Zone, or a Foreign Trade Zone or Sub-Zone during the taxable year. An eligible employee:

   a) Must be certified by the DCEO as "eligible for services". Whenever an employee is certified, a voucher is completed by the applicant and approved by DCEO.

      (1) DCEO informs the taxpayers that they should keep these vouchers in their files in case verification is required. The vouchers are titled "Illinois Department of Commerce and Community Affairs (now the Department of Commerce and Economic Opportunity or DCEO), Enterprise Zone Program, and Jobs Tax Credit Certification Voucher".

      - The form number is IL 420-0544.

        - This form should be requested to verify that the employee is DCEO certified.

   b) Must be hired after the zone was created or after the business was in the zone, whichever is later;

      - The term "hired" means hired by the employer claiming the credit. Employees transferred from another facility of the employer to a facility located in an enterprise zone or federally designated foreign trade zone or sub-zone are not deemed "hired" upon transfer to a facility located in the enterprise zone or federally designated foreign trade zone or sub-zone.

   c) Must be employed in the zone. To be considered "employed in the zone", services must be rendered there, or it must be the base of operations of the services performed; and must be a full-time employee working 30 or more hours a week.

2. The taxpayer's total employment within the zone must increase:

   a) By five or more full-time employees beyond the total employed in that zone at the end of the previous tax year for which a jobs tax credit was taken,

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b) Alternatively, beyond the total employed by the taxpayer on December 31, 1985, whichever is later.

c) If a taxpayer has had employees in the enterprise zone but has never claimed a Jobs Tax Credit, this calculation would be performed comparing the taxpayer's total employment within the zone by the total employed within the zone by the taxpayer on December 31, 1985. REF: Sunshine Letter IT93-0082.

Note: During the audit if there is a question on the status of a taxpayer's certification.

- Do not contact the agency directly; instead submit the inquiry and documentation to your supervisor.
- The information will be forwarded to the Technical Support Supervisor, where it is analyzed and presented to Legal for review, if necessary.
- The Department's liaison will contact DCEO personnel directly if needed. The requested information will then be provided to the auditor by the supervisor.

Example:

Company A was in the East St. Louis enterprise zone when the zone came into existence in 1985. Company A employed 30 people within the enterprise zone prior to and during 1985. Between 1986 and 1990, Co. A lost eight employees. In 1991, Co. A hired 10 qualified employees. Since Company A had never taken a Jobs Tax Credit, A's total employment within the zone for 1991 (32) is compared with its employment within the zone on December 31, 1985 (30). Since A's total employment with the zone did not increase five or more full-time employees, A is not eligible for the Jobs Tax Credit.

If the zone in which the taxpayer is located was created after 1985 and the taxpayer has never claimed a Jobs Tax Credit, the above computation would be computed by comparing the total employment within the zone by the total employed within the zone in the calendar year during which the zone was created. REF: Sunshine Letter IT93-0082, IT94-0031.

3. Eligible employees must be employed 180 consecutive days during the tax year to be "deemed hired".

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Example:

An otherwise eligible employee is hired to work in an Enterprise Zone on August 1, 1987. The employer's tax year ends December 31, 1987. The employee would have worked 153 days during the 1987 tax year and, therefore, would NOT be "deemed hired" in 1987. The employer would not be eligible for the Jobs Tax Credit for this employee for this year.

If, however, the employee in the above situation worked for the entire 1988 calendar year, the employee would meet the 180 consecutive day requirement and would be considered "deemed hired" in 1988. If all other requirements were met, the employer could claim the Jobs Tax Credit on this employee for the 1989 tax year. REF: Sunshine Letter IT94-0031 & IAC § 100.2120(b).

B. CARRYOVER OF EXCESS CREDIT

Any excess credit can be carried forward five years. If a credit carry-forward is involved:

1. The credit needs applied to the earliest year for which there is a liability.

2. If there is a credit from more than one tax year available to offset a liability, the oldest credit will need to be applied first.

VII. INVESTMENT CREDIT – HIGH IMPACT BUSINESS

IITA §201(h) IAC §100.2130

The current IITA § 201(h) allows a credit against Income Tax for investment in qualified property by a High Impact Business. The credit is available to individuals, corporations, trusts, and estates designated by Department of Commerce and Economic Opportunity (DCEO).

Originally, property needed to be placed in service on or after January 1, 1986 in a federally designated Foreign Trade Zone or Sub-Zone (January 1, 1987). For tax years ending on or after January 1, 1989, the requirement that property placed in a Foreign Trade Zone or Sub-Zone was eliminated.

The Investment Credit-High Impact Business is calculated using:

- Schedule 1299-D for corporations and fiduciaries

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High impact business; was created to assist in encouraging development, growth, and expansion of the private sector through large-scale investment and development projects.

These businesses are qualified for the tax advantage because their investments or projects in Illinois are expected to cause or contribute in a significant and substantial way such things as:

- an increase in per capita income
- a reversal in the number of jobs lost
- a decrease in the unemployment rate

High impact businesses qualify for Income Tax credits once the minimum investments required under Illinois law have been placed in service in qualified property.

A. SECTION 5.5 OF THE ILLINOIS ENTERPRISE ZONE ACT

As of September 7, 1989, the credit is not available until the minimum investments in qualified property set forth in Section 5.5 of the Illinois Enterprise Zone Act have been satisfied.

- The credit applicable to such minimum investments shall be taken in the tax year in which the minimum investments have been completed.
- Any credit for additional investments beyond the minimum investment shall be available only in the tax year in which the property is placed in service

To be designated a High Impact Business, a business is required to apply to DCEO, which will certify the taxpayer if it qualifies.

The Department of Revenue is not required to decide regarding a High Impact Business. When conducting an audit, request to see the High Impact Business certification issued by DCEO.

Note: During the audit if there is a question on the status of a taxpayer's certification.

- Do not contact the agency directly; instead submit the inquiry and documentation to your supervisor.
- The information is then sent on to the Technical Support Supervisor, where it will be analyzed and presented to Audit Legal for review, if necessary.
- The Department's liaison will contact DCEO personnel directly if needed. The requested information then provided to the auditor by the supervisor.

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The High Impact Business Investment Credit does not pass-through to shareholders of subchapter S corporations or partners of partnerships.

B. QUALIFIED PROPERTY

The credit is computed based on the qualified property placed in service. To be qualified, property must:

1. Be tangible, new or used including buildings and structural components of buildings;

2. Be depreciable pursuant to IRC § 167 except that "3-year property" does not qualify;

3. Be acquired by purchase (as defined by IRC § 179(d));

4. Be used in an Illinois Foreign Trade Zone on or after January 1, 1986 (or Sub-Zone on or after January 1, 1987). Effective January 1, 1989, it is no longer a requirement that the property be placed in service in a Foreign Trade Zone or Sub-Zone; and

5. Not be eligible for the Enterprise Zone Investment Credit.

The terms "tangible" and "depreciable" have been previously defined in the Section on Replacement Tax Investment Credit. In addition, "Acquired by purchase", "3-year property", "placed in service", "basis" is also discussed in that section.

C. CARRYOVER OF EXCESS CREDIT

The credit cannot reduce a liability below zero.

Effective for years ending on or after December 31, 1987, excess credit can be carried forward to the five years following the excess credit year.

- The credit must first be carried to the earliest year for which there is an Income Tax liability.

- If an excess credit exists from more than one year, the credit from the earliest year is first used.

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Prior to December 31, 1987, there were no carry-forward provisions for this credit.

D. RECAPTURE OF CREDIT

Recapture is required and the Income Tax for a taxable year shall be increased, if during any taxable year:

- Property ceases to be qualified property in the hands of the taxpayer within 48 months after being placed in service,
- The sites of any qualified property are moved outside the Foreign Trade Zone (or Sub-Zone) within 48 months after being placed in service (for years prior to January 1, 1989).

A reduction of the basis of qualified property resulting from a redetermination of the purchase price shall be deemed a disposition of qualified property to the extent of such reduction.

The recapture of any amount of credit is calculated using:
- Form 4255

VIII. INCOME TAX CREDIT FOR REPLACEMENT TAX LIABILITY

IITA §201(i) IAC §100.2140

Effective for years ending on or after December 31, 1986 through years ending prior to December 31, 2003, IITA § 201(i) provides a credit against Income Tax based on Replacement Tax liability. This credit was created to provide a single tax base for computing both the Income and Replacement Tax liabilities. The amount of Replacement Tax deducted in computing federal taxable income is added back under IITA § 203(b)(2)(B), but prior to the enactment of the IITA § 201(i) credit, was then subtracted for purposes of computing income tax.

The credit is calculated on the IL-1120, Part IV.

The Income Tax Credit for Replacement Tax Liability does not pass-through to shareholders of subchapter S corporations or partners of partnerships.

FOR TAX YEARS ENDING AFTER DECEMBER 31, 1988:

- The credit is calculated by dividing:

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- The Illinois base income from Part III of the IL-1120 by
- total base income from Part I.
- Multiply this percentage by the net Replacement Tax liability for the year.
- Then multiply this amount by the current Income Tax rate.

FOR TAX YEARS ENDING ON OR BEFORE DECEMBER 31, 1988:

- The credit is calculated by multiplying:
  - The net Replacement Tax liability for the year by
  - the apportionment percentage or
  - by one if it is a non-apportioning company.
  - This amount is then multiplied by the current Income Tax rate

CARRYOVER OF EXCESS CREDIT

Any credit earned on or after December 31, 1986, which is unused in the year earned because it exceeds the Income Tax liability for the year, may be carried forward for five taxable years. The credit must be applied first to the earliest year for which there is a liability. If there is a credit available from more than one taxable year, the oldest credit used first.

No credit may be earned or carried forward into a tax ending on or after December 31, 2003.

Note: If there is a reduction in the Replacement Tax liability for a year in review, the credit needs to be recalculated and reduced as necessary. If, after recalculating the credit; there is a reduction in the amount carried forward; the taxpayer is required to file an amended return to correct the amount.

IX. TRAINING EXPENSE CREDIT

IITA §201(j) IAC §100.2150

The current IITA § 201(j) provides a credit against Income Tax for certain training expenses incurred for tax years ending on or after December 31, 1986 and prior to December 31, 2003. This credit is available to individuals, corporations, trusts, and estates. A "pass-through" of the credit can partner and subchapter S Corporation shareholders according to their distributive share of income.

The Training Expense Credit is calculated using:

- Schedule 1299-A for partnerships and S corporations
- Schedule 1299-D for corporations and fiduciaries

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A. QUALIFIED EXPENSES

IAC § 100.2150 states that all amounts paid for educational or vocational training in semi-technical or technical fields or semi-skilled or skilled fields are eligible for the credit.

The Department's position is that training does not require being in new technologies or any field needs exclusion from receiving training, which would qualify for the credit. Therefore, training can be provided to both "blue collar and white collar" employees, "professional" employees, included are doctors, lawyers, accountants, engineers, etc. and management employees.

The credit is for all amounts paid or accrued, on behalf of all persons employed by the taxpayer in Illinois, or Illinois residents employed outside of Illinois by a taxpayer. REF: IAC § 100.2150(a).

- The term "persons employed by the taxpayer in Illinois" shall include employees whose compensation is subject to withholding under IITA § 701 (including employees who are exempt from withholding pursuant to IITA § 701(d)).

- Sole proprietors, partners in partnerships, shareholders of corporations, beneficiaries of trusts or estates, or other individuals who own an interest in the employer are not employees for purposes of the credit unless they are able to demonstrate that they are also employees of the business. REF: IAC § 100.2150(e).

B. ELIGIBLE TYPES OF TRAINING

- Training an employee to improve that employee's job skills, which is directly related to his/her current employment. Job-linked training that offers special skills for career advancement or that is preparatory for, and leads to, a job with definite career potential.

- Training necessary to implement Total Quality Management for improvement systems within the workplace.

- Training related to machinery or equipment.

- Job-linked basic skills such as "English as a second language" or remedial training necessary for employees to function safely and effectively in the workplace or a prerequisite for other training. Some examples follow:

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- Training of a machine operator in skills necessary to operate a computer-assisted manufacturing machine.

- Training of employees of a retailer in the operation of a cash register system that result in faster sales and greater inventory control because it is linked to the taxpayer's headquarters.

- A required course for supervisors in how to supervise employees who work at home because of the installation of a computer system with linked terminals in the employees' homes.

- Self-study courses which meet the criteria of semi-technical, technical, semi-skilled or skilled. Self-study is contrasted with "down-time" reading which does not qualify

- Continuing education-type training.

Note: Training does not have to occur in a classroom or given by an employer. An employer may contract with a third party to provide training. Training does not have to occur on the taxpayer's premises or even in the State of Illinois.

Examples of occupations and the types of classes which would qualify for the credit:

- Class for welders on how to operate a new computer-controlled welder;

- Class for surgeons on how to use a new laser guided scalpel;

- Classes on desert building technologies for Illinois-resident architects sent to Saudi Arabia by their firm for 4-month shifts to build a new hospital;

- Classes for all administrative employees in Microsoft Office upgrades prior to the installation of the software on all their desk top computers; and

- Class on negotiation skills taken by middle managers charged with the responsibility of negotiating union contracts.

C. INELIGIBLE TYPES OF TRAINING

- Self-help classes such as "smoking cessation", "stress management" or "time management", etc.; and

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- New employees' orientation or providing information on employee benefits, vacation and sick day policies, etc.

Examples of occupations and classes which would not qualify:

- Training on desert living and Islamic law for the architects assigned to Saudi Arabia; and

- Weight training for the star tackler of a professional football team.

Note: The above examples are attempting to demonstrate that the type of training and the occupation of the employee receiving it will have to be evaluated on a case-by-case basis to determine the eligibility for the credit.

To constitute eligible training under Section 201(j), there must be a direct connection between the training and a field of employment in which the employee engages in the sense that the training must be specifically designed to enhance the employee's ability to effectively engage in a field of employment.

Department regulations § 100.2150(c)(2) indicates that while the terms "semi-technical or technical fields or semi-skilled or skilled fields" do not refer to any occupation, the credit is intended for the costs of training designed to improve an employee's job skills within the scope of the employment. The regulations authorize the credit for "job-linked training that offers special skills for career advancement or that is preparatory for, and leads to, a job with definite career potential," and "job-linked basic skills … necessary for employees to function effectively and safely in the workplace, or as a prerequisite for other training." 86 Ill. Adm. Code § 100.2150(c)(2).

The requirement of a direct connection between the training and the employee's field of employment is consistent with the Legislative purpose in enacting the credit.

D. EXPENSES ELIGIBLE FOR THE CREDIT

1. Compensation of Employees
   Compensation is defined in IITA § 1501(a)(3)

   - For time spent in training others in in-house training. However, the compensation must be prorated based on the amount of time spent in conducting the training;

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- For time spent in preparing for training as a student or an instructor; and

- For time spent attending classes.

2. Fringe Benefits

   When the regulations were adopted, it was the Department's position that fringe benefits were not eligible expenses. However, that position was reversed as the result of an administrative hearing decision in Abbott Laboratories, Inc. v. DOR, Docket 98-IT-0304 (Called Shanghai, Inc. v. DOR, IT 02-01, on the Department's web site)

   - As a direct result of the hearing decision, compensation of an employee as defined in IITA § 1501(a)(3) includes the employer's costs for that employee's:

     - life insurance;
     - medical insurance;
     - dental or disability insurance;
     - deferred compensation;
     - pension and profit-sharing plans;
     - dependent care assistance;
     - transportation fringe benefits; and
     - Other fringe benefits.

   - If these amounts are included in compensation of employees for time spent in training others in-house, the compensation must be pro-rated on the amount of time spent in conducting the training.

     Unemployment, payroll, and other taxes imposed on the employer are **not** eligible expenses because:

     a) Such amounts are not paid on behalf of the employee, even if computed as a percentage of an employee's wages or as a fixed amount per employee.

     b) Only amounts expended for eligible training and which are deducted in the computation of federal taxable income will qualify as eligible training expenses.

Note: Any fringe benefits that are allowed as eligible expenses **must** have been deducted in the computation of federal taxable income. REF: Abbott

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Laboratories, Inc. v. DOR (2001), Docket 98-IT-0304 (Called Shanghai, Inc. v. DOR, IT 02-01, on the Department's web site).

3. Costs of Materials

   The cost of materials used for in-house training classes such as slides, handouts, etc. will qualify for the credit because such costs are expenses of training.

4. Costs of Training Facilities

   Training facilities and equipment could be rented or owned by the taxpayer and some of the costs would be eligible expenses. The rent expense for the training facility is an allowable expense but it must be prorated based on the actual time spent in conducting eligible training and for other uses.

   The capitalized costs of training facilities or equipment owned by a taxpayer cannot be claimed for the credit. However, the depreciation expense associated with the capital expenditures for a training facility is an allowable expense. This expense must be prorated also based on the actual time spent conducting eligible training and for other uses.

5. Costs of Registration

   The costs of registration with state, federal or industry authorities may be eligible expenses, if such costs are related to eligible training. These costs could include allocable wages of employees performing the registration.

   For example, the employer is conducting a training course that qualifies for the employees' continuing professional education requirements. Since the course must comply with the continuing professional education criteria of the professional organization, the costs incurred in registering the course with that professional organization would be eligible for the credit.

6. Tuition Reimbursement

   Tuition reimbursement is an eligible expense if the training qualifies and the tuition amounts were deducted in determining the employer's federal taxable income.

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7. Costs of Travel and Lodging

   Costs of travel and lodging expended to attend eligible training classes is an allowable expense if the costs were deducted in determining the employer's federal taxable income.

E. INELIGIBLE TRAINING EXPENSES

The following expenses are not eligible for the credit:

1. The cost of the training facility and equipment is not an eligible expense. Capital costs are not eligible for the credit. However, as noted above, depreciation expense is eligible;

2. Compensation of an employee for "down time" spent informally training. For example, a mechanic who has no machinery to work on spends that idle time reading about new equipment. The wages paid for that time would not be eligible for the credit;

3. Compensation of an employee for time spent supervising another employee is not an eligible expense. For example, the compensation for a supervisor moving from work station to work station answering questions and reviewing work would not qualify for the credit; and

4. The cost of meals provided to employees during training sessions is not eligible expenses.

F. DOCUMENTATION STANDARDS – REVISED 10/2/2002

IAC § 100.2150(d)(3) provides that:

Employers must maintain records enough to document that the training is eligible training and of the amounts expended for eligible training expenses. This documentation must include detailed information concerning the methodology utilized in determining any average or standard costs used by the employer to compute eligible costs. The documentation must be enough to demonstrate that the training is on behalf of persons employed by the taxpayer in Illinois, or Illinois residents employed outside of Illinois by the taxpayer.

The employer may use the documentation required for the Industrial Training Program of the Illinois Department of Commerce and Community Affairs (see 56 Ill. Adm. Code 2650.120), or in

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compliance with the requirements of the Illinois Secretary of State's Workplace Literacy Program (see 23 Ill. Adm. Code 3040.220 and 3040.240.

Some of the documentation that should be requested from the taxpayer to verify the training expense credit claimed is listed below. This list should not be considered all-inclusive. The taxpayer may have other support for the credit that is acceptable. The Auditor should use judgment in determining if the support provided is adequate.

- List of personnel receiving training, name and job title.
- IL-941s or UC-3's to verify that employees are Illinois residents.
- Complete description of the training, i.e. syllabus, training objectives, etc.
- Job description of each employee to determine if the training is job-linked.
- Time Reports of employees or class attendance sheets documenting that they were in training.
- Time Reports of in-house trainers to document time spent preparing for training or putting on a class.
- Contracts with vendors providing training.
- Invoices and receipts to document expense of training materials.
- Travel vouchers or expense reports to document travel and lodging expenses to attend training classes.
- Federal returns and work papers for tracing expenses claimed.

Note: The importance of the taxpayer providing enough documentation to support the credit claimed cannot be overemphasized. If enough documentation is not provided, the credit will be disallowed.

There may be cases where the Computer Assisted Auditing (CAA) staff can assist the auditor with the review of information to support the credit. Contact your local CAA staff to request assistance using the current CAA referral procedures.

G. CARRYOVER OF EXCESS CREDIT

The credit is not allowed to the extent that it would reduce the Income Tax liability of any year below zero. Any excess credit can be carried forward for five taxable years following the year for which the credit is first computed to offset any Income Tax liability incurred. The credit must be applied first to the earliest year for which there is a liability. If there is a credit available from more than one taxable year, the earliest credit earned shall be applied first.

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No excess credits may be carried over to tax years ending on or after December 31, 2003.

X. RESEARCH AND DEVELOPMENT CREDIT

IITA §201(k) IAC §100.2160

IITA § 201(k) provides for a credit against Income Tax for qualifying research and development expenditures. The credit is in effect for tax years ending after July 1, 1990 through tax years ending prior to December 31, 2003; reinstated for tax years ending on or after December 31, 2004 through tax years ending prior to January 1, 2021. The credit is available to individuals, corporations, trusts and estates. The credit is equal to 6.5% of the qualifying expenditures for increasing research activities in Illinois.

Originally, the credit did not pass-through to partners of partnerships or shareholders of Subchapter S corporations. REF: Sunshine Letters IT91-0115, IT93-0157, IT94-0119 and IT95-0035. However effective 1/1/99, IITA, § 201(k) was amended to allow a pass-through of the R& D credit to partners of partnerships and shareholders of Subchapter S corporations. This includes the owners of limited liability companies, if the company is treated as a partnership for purposes of federal and state income taxation.

The Research and Development credit is calculated using:

- Schedule 1299-D for corporations and fiduciaries

A. DEFINITIONS CONTAINED IN SECTION 201(k)

- "Qualifying expenditures" expenditures that qualify under IRC § 41 for purposes of the federal credit for activities that are conducted in Illinois.

- "Qualifying expenditures for increasing research activities in Illinois" is the excess of the qualifying expenditures incurred for the taxable year over qualifying expenditures for the base period.

- "Qualifying expenditures for the base period" means the average of the qualifying expenditures for each year in the base period.

- "Base period" is the three taxable years immediately preceding the taxable year for which the determination is being made.

For purposes of determining whether an increase in research activities has taken place, the determination will be made with respect to the research activities in Illinois of all members of the combined Illinois return rather than an individual member's return.

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B. CARRYOVER OF EXCESS CREDIT

Any credit more than the tax liability for the taxable year may be carried forward to offset the Income Tax liability of the taxpayer for the next 5 years or until it has been fully utilized whichever occurs first.

- If an unused credit is carried forward to a given year from two or more earlier years that credit arising in the earliest year is applied first.
- If a tax liability for the given year remains, the credit from the next earliest year is applied.
- Any remaining unused credit or credits can be carried forward to the next following year in which a tax liability exists. However, the credit can only be carried forward 5 years from the year in which the taxpayer incurred the expense for which the credit was given. Any unused credit is then forfeited.

Important: The credit was reinstated for tax years ending on or after December 31, 2004, but no credit carryovers were permitted from tax years ending prior to that date. Therefore, the 5-year credit carryovers to future tax years will again start with credits earned in tax years ending on or after December 31, 2004.

No credit can be earned in tax years ending on or after December 31, 2003 and prior to December 31, 2004, so no carryforward from those years are possible.

Note: Form 1299-D applies the carryforwards by combining the excess of all credits with 5-year carryforwards earned in a tax year over the tax liability after applying carryforwards and treats this amount as a single carryforward. For tax years ending on or after December 31, 2003, the amount of any carryover should be computed as if the R & D credit had been applied before any of the other credits with 5-year carryforwards earned in the same year in order to determine what amount of the R & D credit carryforwards remained unused as of that year and were lost because of the repeal of the credit.

C. EXAMPLES OF R & D CREDIT

The following are examples of how to compute the Research and Development credit.

Example 1

Corporation A was in business in Illinois since 1980. Corporation A incurred the

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following expenses for qualified research activities in Illinois for the calendar years 2006, 2007, 2008 and 2009.

	2006	**2007**	**2008**	**2009**
Wages for qualified services	$ 0	$ 50,000	$ 0	**$100,000**
Supplies	$ 0	$ 5,000	$ 0	**$ 8,000**
Contract research expenses (65%)	$ 0	$ 100,000	$ 0	**$ 200,000**
Basic research expenses paid to a qualified organization	$ 0	$ 20,000	$ 0	**$ 0**
Totals	**$ 0**	**$175,000**	**$ 0**	**$308,000**

The qualified expenditures for the base period would be:

Total qualified expenditures for 2006	$ 0
Total qualified expenditures for 2007	$ 175,000
Total qualified expenditures for 2008	$ 0
Total qualified expenditures for base period	$ 175,000
Average for base period	$ 58,333

The total qualifying expenditures for 2009 are then compared to the base period average and the excess qualifying expenditures for 2009 is computed.

Total qualified expenditures for 2009	$ 308,000
Average qualified expenditures for base period	$ (58,333)
Excess of 2009 expenditures over base period	$ 249,667

The $249,667 is then multiplied by 6.5% to arrive at a Research and Development Credit amount of $16,228 for 2009. If the tax liability for 2009 is only $10,000 then the taxpayer will have excess credit to carry forward of $6,228.

<u>Example 2</u>

Corporations A, B and C incurred the following expenses for qualified research activities in Illinois:

	2006	2007	2008	2009
Corp A	$ 50,000	$ 50,000	$ 50,000	$ 0
Corp B	$ 25,000	$ 25,000	$ 100,000	$ 200,000

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Corp C	$ 75,000	$ 125,000	$ 100,000	$ 100,000
Total	$ 150,000	$ 200,000	$ 250,000	$ 300,000

Corporations A, B and C filed a combined Illinois return for the calendar years of 2006, 2007, 2008 and 2009. The R&D Credit for 2009 is determined based upon the combined activities of the group and is calculated as follows:

Total qualified expenditures for 2009	$ 300,000
Average qualified expenditures of base Period ($150,000+$200,000+$250,000)/3)	$ 200,000
Excess of 2009 expenditures over base period	$100,000
R&D Credit for 2009 (6.5%)	$ 6,500

D. COMPUTATION OF THE CREDIT WHEN CHANGES IN ILLINOIS COMBINED RETURN MEMBERSHIP

If a corporation is a member of the combined Illinois return during the year in which the credit is being claimed but was not a member of the combined return during one or more of the base period years.

- The average qualified expenditures for the base period will be computed as if the corporation was a member of the combined Illinois return for the entire base period.

If a corporation is not a member of the combined Illinois return during the year, in which the credit is being claimed but was a member of the combined return during one or more of the base period years.

- The average qualified expenditures for the base period will be computed as if the corporation was not a member of the combined return for the entire base period. REF: IAC § 100.5270(d)(5).

Facts:

The following examples illustrate the computation of the credit when the membership of the combined Illinois return changes at some point during either the base period or the year in which the credit is being claimed.

Assume the following facts for both examples:

Corporations A, B and C incurred the following expenses for qualified research activities in Illinois:

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	2006	2007	2008	2009
Corp A	$ 50,000	$ 50,000	$ 50,000	$ 0
Corp B	$ 25,000	$ 25,000	$ 100,000	$ 200,000
Corp C	$ 75,000	$ 125,000	$ 100,000	$100,000
Total	$ 150,000	$ 200,000	$ 250,000	$ 300,000

Example 1

Corporations A and B filed a combined Illinois return for 2006. Corporation C filed a separate company return for 2006. Corporation A purchased the common stock of Corporation C on 1/1/07. Corporations A, B and C filed a combined return for 2007, 2008 and 2009.

The $75,000 of expenses for qualified research activities in Illinois incurred by Corporation C in 2006 would be included in the calculation of the average qualified expenditures for the base period.

The credit for the 2009-combined Illinois return would be calculated as follows:

Total qualified expenditures for 2009	$ 300,000
Average qualified expenditures of base period (($150,000+$200,000+$250,000)/3)	$ 200,000
Excess of 2009 expenditures over base period	$ 100,000
R&D Credit for 2009 (6.5%)	$ 6,500

Example 2

Corporations A, B and C filed combined Illinois returns for 2006, 2007 and 2008. On 1/1/09, Corporation A sold the common stock of Corporation C to Corporation P (an unrelated corporation). In determining the proper amount of the R&D Credit that can be claimed on the Corporations A & B combined Illinois return for 2009, the expenses for qualified research in Illinois incurred by Corporation C for 2006, 2007 and 2008 are disregarded when determining the average qualified expenditures for the base period.

The 2009 Corporations A & B combined return would be calculated as follows:

Total qualified expenditures for 2009	$ 200,000
Average qualified expenditures of base period (($75,000+$75,000+$150,000)/3)	$ 100,000
Excess of 2009 expenditures over base period	$ 100,000
R&D Credit for 2009 (6.5%)	$ 6,500

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E. POLICY ON AUDITING R & D CREDITS

1. COMPLETED FEDERAL AUDIT

Since the Illinois Research and Development Credit is based on the Federal Research Credit (IRC § 41), expenses that qualify for the federal research credit will qualify for the R & D Credit if they are incurred in Illinois. Therefore, the results of a federal audit will most likely impact the Illinois credit.

However, we have encountered the situation where the IRS has closed an audit for the same period that we are currently auditing and made no adjustment to the research credit. When our Auditors reviewed the expenses claimed to verify that they were incurred in Illinois, they discovered expenses or projects that did not appear to qualify for the credit according to the IRS code and regulations.

A prime example is “internal use computer software projects”. When they contacted the IRS agent to determine the scope of the federal audit, the Agent indicated that even though the IRS audit plan included a review of the research credit, they performed only a cursory review and did not actually audit the credit.

The auditor will have to examine the projects and expenses claimed for the research and development credit unless the IRS has conducted an audit of these projects and expenses. If the IRS has audited the projects and expenses, then the auditor will need to verify that the expenses were incurred in Illinois. In addition, the auditor should verify calculation of the credit, the base period and the amount and year of the credit carryover.

2. FEDERAL AUDIT PENDING

If a taxpayer is currently under federal audit for the same period that is covered by the Department’s audit, the Auditor can delay the completion of that audit until the federal audit is finalized provided that the IRS confirms that they are auditing the Research Credit and the taxpayer is willing to extend the statute of limitations. This should only be done when the federal audit is within a year of completion and with the supervisor’s approval. All areas of the audit must be completed including verifying that the expenses claimed for the R & D credit were incurred in Illinois and all aspects of the credit were correctly computed. Once the RAR is finalized, the audit can be completed and turned in without further delay. If the

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taxpayer informs the Auditor that the federal audit is going to be unagreed, the Illinois audit should be completed without further delay applying the federal changes. The Auditor may need to split the audit between agreed and unagreed portions.

3. NO FEDERAL AUDIT PENDING

The department will encounter taxpayers who are not under a federal audit for any period, have not been notified that they will be under audit or are years away from being under audit for the same period as the Department's audit.

For example, if the IRS is currently auditing 2002 and the Department is auditing 2006 through 2008, it will be many years before the 2006 through 2008 federal audit will be completed. Therefore, in these situations, the Auditor will perform a complete audit of the R & D credit that will include evaluating the projects to determine if they qualify under federal rules, verifying that the expenses are qualified and are incurred in Illinois.

As in other areas of the Department's audits, sampling techniques can be utilized to perform an audit of this area. If the Auditor determines that Computer Assisted Audit's (CAA) assistance is needed, CAA should be contacted using the current CAA referral procedures. If CAA cannot provide sampling assistance because of record incompatibility or the small volume of transactions, the Auditor can choose the option of completing a detail audit or a manual sampling audit to verify the veracity of the taxpayer's claimed R & D Credit.

F. AUDIT PLAN

1. REQUEST INFORMATION TO DETERMINE THE SCOPE OF THE AUDIT

a) Review Schedule 1299-D, section on the Research and Development Credit. Schedule 1299-D breaks down the credit into qualifying wages, supplies and contract research expenses.

- Reviewing the makeup of the credit, you can determine where you should spend most of your audit time.

- Review Federal Form 6765.

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- The taxpayer could possibly have the federal expenses broken down by state. It is a good idea to request the federal work papers and find out who prepared them.

- Ask to see any memos or guidelines used to collect this information.

Note: Generally, the bulk of the credit should consist of wages. If a high percentage of expenses is classified as supplies or contract research, you may want to devote audit time to those areas. If not, you may want to spend your time just reviewing salaries.

2. REQUEST ALL WORKPAPERS USED TO COMPUTE THE RESEARCH CREDIT

   a) These work papers should include all entities.

   b) Expenditures should be broken down into wages, supplies, and contract research expenses.

   c) Identify whether the taxpayer is computing the credit using a:

      (1) Cost center/departmental approach

         (a) Work papers should identify each cost center or department by its cost center or department number.

      (2) Project approach

         (a) Each project should be identified by name and cost component (wages, supplies, contract research).

         (b) Work papers should contain each wage, supply and contract research expense account by its appropriate name and account number.

3. PLAN THE AUDIT STRATEGY

   a) In auditing the research tax credit, the auditors should employ a "two-prong" approach.

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(1) Look at the activity that is being conducted by the taxpayer to determine whether it is a qualifying research activity as defined in IRC § 41(d).

(2) Determine whether the expenses claimed by the taxpayer are allowable under IRC § 41 and incurred in Illinois

4. REQUEST A MEETING WITH THE TAXPAYER TO EXPLAIN THE WORKPAPERS AND DISCUSS THE OVERALL RESEARCH ACTIVITY

- Presented an Information Document Request (IDR-70) prior to the meeting to inform the taxpayer what subjects and potential questions you would like to discuss at the meeting. The following are only suggested questions to ask the taxpayer. Auditors must determine what they need to ask depending on their situation to decide.

  - Does the taxpayer, in the preparation of the work papers used to compute the research credit, have a specific theory and methodology behind what expenses were included in the credit? If so, it would be beneficial for the auditor to understand this theory and methodology. The taxpayer should explain why certain cost centers or departments were included in the credit or why certain expenses, employees, contractors, etc. were included in the credit.

  - Who prepared the work papers and made the decisions about what research activity and what expenses qualified for the credit?

  - What documentation is available to support the qualified research activity?

  - What criteria did the taxpayer use to determine what research and expenses qualified for the credit?

  - Did the taxpayer send out surveys to employees? If the taxpayer sent surveys to specific employees to complete, submit an EDA- 70 requesting copies of these surveys and responses. Have the taxpayer show how these surveys were used in the calculation. Also, request the instructions that accompanied the surveys.

Ask as many questions, as you feel appropriate relating to the costs, activities etc. By doing this, it may eliminate the long process of having to ask these questions through an EDA- 70. Taxpayer responses to questions should be documented on the EDC-5. It will also identify specific documentation that the auditor may request to support the expenses or research activity. A tour of the

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research facility may sometimes be beneficial, especially if the research activity will be reviewed.

G. BASE PERIOD COMPUTATION – GENERAL

A Word of Caution: The federal credit base period is completely different from the Illinois base period.

For purposes of this credit, the amount of qualifying expenditures for increasing research activities in Illinois is computed by taking the excess of the qualifying expenditures for the taxable year over the average annual qualified expenditures for the base period. Base period defined as the three tax periods immediately preceding the determination year.

H. SHORT BASE PERIOD OR SHORT DETERMINATION YEAR

One of the first steps to take in auditing the R & D Credit is verifying the base period. The term "base period" generally means the three taxable years immediately preceding the year for which the credit is being determined ("determination year").

However, the taxpayer could have a short base period year or a short determination year or both. Since the equitable comparison of the average base period expenses to the determination year expenses should be made using the same number of days, the short period or periods will need to be modified. (REF: Federal Regulations 1.41-3(d)) The federal regulation requires the modification be made by months. However, the Illinois return instruction uses the number of days.

To annualize a short base period year, the amount of the qualified expenditures must be multiplied by the total number of days in a full year and the result should be divided by the number of days in the short taxable year.

Qualified Expenditures	**X**	**365 days**
Number of Days in the short taxable year		

To de-annualize the average base period to compare with the short determination year, the average base period must be multiplied by the number of days in the short determination year and divide the results by the total number of days in a full year.

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Average Base Period Expense	**X**	**Number of Days in Short Determination year**
365 Days		

1. Example: Base Period Calculation with Short Tax Year

The taxpayer had qualified research expenditures for calendar year 2011 of $200,000. The three taxable years immediately preceding, the determination year includes a short year as follows:

The short year 12/08 qualifying expenditures must be annualized as follows:

Year	Expenditures
7/1/08 - 12/08	$ 50,000
1/1/09 - 12/09	$ 200,000
1/1/10 - 12/10	$ 225,000

Qualifying expenditures	$50,000
Multiplied by the number of days in the year	365
Divided by the number of days taxable in IL	184
Annualized expenditures	$99,185

The base period is calculated as follows using the annualized expenditures:

Year	Expenditures
7/1/08 - 12/08	$ 99,185
1/1/09 - 12/09	$ 200,000
1/1/10 - 12/10	$ 225,000
Total of 3 Periods	$ 524,185
Divided by 3	$ 174,728

The determination year expenses of $200,000 reduced by the average base period expenses of $174,728 equals the credit base of $25,272. The amount of credit available to the taxpayer is $1,643.

2. Example: Base Period Calculation with Short Determination Year

When the determination year is less than 12 months, you must de-annualize the average base period to compare it with the determination year.

The taxpayer had qualified research expenditures for short year 1/1/11 through 6/7/2011 of $100,000. The three taxable years immediately

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preceding the determination year reported Illinois qualified expenses as follows:

Year	Expenditures
1/1/08 – 12/08	$ 150,000
1/1/09 – 12/09	$ 200,000
1/1/10 – 12/10	$ 225,000
Total Expenses	$ 575,000
Divided by 3	$ 191,667

The average base period of $191,667 must be multiplied by 158 (number of days in the determination year) and divided by 365:

Base Period Average Qualifying Expenses	$191,667
Multiplied by 158	$30,283,386
Divided by 365 days	$82,968

The determination year expenses of $100,000 reduced by the de-annualized average base period expenses of $82,968 equals a credit base of $17,032. The amount of credit available to the taxpayer is $1,107.

3. Example; Base Period Calculation with Short Base Period and Determination Year

First, the short base period year must be annualized to calculate the average of the three base period years. Then, the average of the base period must be modified to compare to the short determination year.

The taxpayer had qualified research expenditures for short year 1/1/11 through 6/7/2011 of $100,000. The three taxable years immediately preceding, the determination year includes a short year as follows:

Year	Expenditures
7/1/08 - 12/08	$50,000
1/1/09 - 12/09	$200,000
1/1/10 - 12/10	$225,000

The short year 12/08 qualifying expenditures must be annualized as follows:

Qualifying expenditures	$50,000
Multiplied by the number of days in the year	365

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Divided by the number of days taxable in IL	184
Annualized expenditures	$99,185

The base period is calculated as follows using the annualized expenditures:

Year	Expenditures
7/1/08 - 12/08	$99,185
1/1/09 - 12/09	$200,000
1/1/10 - 12/10	$225,000
Total of 3 Periods	$524,185
Divided by 3	$174,728

The average base period of $174,728 must be multiplied by 158 (number of days in the determination year) and divided by 365:

Base Period Average Qualifying Expenses	$174,728
Multiplied by 158	$27,607,024
Divided by 365 days	$75,636

The determination year expenses of $100,000 reduced by the de-annualized average base period expenses of $75,636 equals a credit base of $24,364. The amount of credit available to the taxpayer is $1,584.

I. QUALIFYING EXPENDITURES

Qualifying expenditures or "qualifying research expenses" are the sum of the in-house research expenses and the contract research expenses paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer. REF: IRC § 41(b).

Note: To be eligible for the Illinois research and development credit, the expenses **must** also be for research activities conducted in Illinois.

The Federal Tax Reform Act of 1986 amended the definition of the term "qualified research" for purposes of the credit computation. To be eligible for the research credit under the 1986 Act, research must satisfy not only the IRC § 174 definition of research and experimental expenditures but must be:

- Undertaken for discovering information that is technological in nature, the application of which is intended to be useful in developing a new or improved business component of the taxpayer. In addition, the research is eligible for the credit only if substantially all the activities of the research constitute

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elements of a process of experimentation for a new or improved function, performance, reliability or quality.

Consistent with the objective of narrowing the scope of the credit to technological advances in products and processes, the 1986 Federal Act set forth several exclusions in IRC § 41(d)(4) from eligibility for the credit. H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess.68 (1986), 1986-3 (Vol. 4) C.B. 68, 74.

J. REVIEW OF PROJECTS

To be a qualified research expense, the taxpayer must be able to show the auditor that the research activity being performed meets all four tests below. The burden of proof is on the taxpayer to show that the research being performed represents qualified research. The taxpayer should identify each qualified business component and provide documentation supporting the four tests. The auditor must realize the research activities or projects being reviewed may be highly factual and technical.

A WORD OF CAUTION: This area can be very technical and time consuming. Do not spend a lot of audit time trying to disallow a research project unless the activity is blatantly non-qualifying, and your Supervisor agrees that this is a worthwhile use of audit time. The IRS has had little success in disallowing research projects and prevailing in court. However, if you and your Supervisor choose to spend time in reviewing the research projects, the following section will apply:

1. THE ACTIVITY OR PROJECT MUST MEET ALL OF THE TESTS OF IRC § 41(D).

The auditor should request a list of each qualifying project or activity along with a complete description of that activity or project. Projects or activities showing the highest audit potential should be selected for examination. Under IRC § 41(d) the term "qualified research" means these four requirements need to be met.

- *Decide which expenditures may be treated as expenses under section 174, REF: IRC § 41(d)(1)(A));*
  - The Section 174 Test

    Research expenditures must qualify as expenses under § 174. Section 174 generally allows research and experimentation expenditures as a current deduction that are paid or incurred by the taxpayer in connection with the operation of a trade or business.

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The phrase "carrying on a trade or business" has the same meaning for this credit as it does for IRC §162 (Trade or Business Expenses).

- Expenses paid or incurred "in connection with a trade or business" within the meaning of IRC § 174(a) (relating to the research and experimental expense deduction) do not necessarily meet the "carrying on a trade or business" requirement of the R&D Credit. REF: CFR § 1.41-2(a)(1).

  To qualify for the R&D Credit, research expenses must relate to a trade or business being carried on by the taxpayer at the time the expenses are paid or incurred.

  - Research expenses paid or incurred by the taxpayer in developing a product, the sale of which would constitute a new trade or business for the taxpayer (rather than an expansion of an existing trade or business), do not qualify for the credit. REF: CFR § 1.41-2(a)(2)

    If a corporation is a member of a unitary group filing a combined Illinois return, it will be carrying on a trade or business if any member of the combined return is carrying on the trade or business.

    Example: If one member is performing in-house research on behalf of another member, the member performing the work will be carrying on the trade or business of the member for whom the research is being conducted. REF: CFR § 1.41-8(a)(4) and (e)(2) except that the IRC Regulation discusses commonly controlled groups.

    - The expenses do not qualify if the product or result of the research is intended to be transferred to another entity in return for license or royalty payments and the taxpayer does not use the product of the research in the taxpayer's trade or business. REF: CFR § 1.41-2(a)(1).

    For tax years beginning after December 31, 1989, the "carrying on a trade or business" requirement is disregarded for in-house research expenses of certain startup ventures. In these cases, a taxpayer will be treated as meeting the trade or business requirement if, at the time such in-house research expenses are paid or incurred, the principal purpose of the taxpayer in making the expenditures is to use the results of the research in the active

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conduct of a future trade or business of the taxpayer or of one or more other persons who, with the taxpayer, are members of the same unitary group. REF: IRC § 41(b)(4) The IRC section refers to members of a controlled group instead of a unitary group.

Final regulations under section 174 issued in October of 1994 define research and experimental expenditures as follows:

Expenditures represent research and development costs in the experimental or laboratory sense if they are for activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. Uncertainty exists if the information available to the taxpayer does not establish the capability or method for developing or improving the product or the appropriate design of the product. Whether expenditures qualify as research or experimental expenditures depends on the nature of the activity to which the expenditure relates, not to the nature of the product or improvement being developed or the level of technological advancement the product or improvement represents. CFR §174-2 (a)(1).

- *Undertaken for discovering information which is technological in nature, REF: IRC § 41(d)(1)(B)(i);*
  - The Discovery Test

  The discovery test requires that the research be undertaken for discovering information that is technological in nature. Discovering information means obtaining knowledge that expands or refines the common knowledge of skilled professionals in a field of technology or science. Research activities for purposes of the discovery process must fundamentally rely on the principles of the physical or biological sciences, engineering, or computer science. REF: IRC § 41(d)(1)(B)(i).

- *Intended to be useful in the development of a new or improved business component of the taxpayer, REF: IRC § 41(d)(1)(B)(ii)); and*
  - The Business Component Test

  The business component test, which is part of the discovery test, requires that the research be undertaken for discovering information the application of which is intended to be useful in the development of a new or improved business component of the taxpayer.

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The tests are to be applied separately to each business component of the taxpayer. The term business component is defined as any product, process, computer software, technique, formula, or invention to be held for sale, lease, or license, or used by the taxpayer in a trade or a business of the taxpayer. (See section below on internal use computer software)

There is a special rule for production processes. Any plant process, machinery, or technique for commercial production of a business component shall be treated as a separate business component (and not as part of the business component being produced). REF: IRC § 41(d)(2)(A) through (C).

- *Substantially all the activities of which constitutes an element of a process of experimentation for a permitted purpose described in IRC § 41(d)(3).*

  - The Process of Experimentation Test

The process of experimentation test requires that substantially all the activities that constitute elements of a process of experimentation relate to a new or improved function, performance, reliability or quality.

(a) CONSTITUTES ELEMENTS OF A PROCESS OF EXPERIMENTATION FOR A PERMITTED PURPOSE

- Process of experimentation

The taxpayer must show that substantially all its activities must constitute elements of a process of experimentation.

- For a permitted purpose

The final test is that the research must be performed for a permitted purpose. IRC § 41(d)(3)(A) states a permitted purpose must be related to:

- new or improved function; or
- Performance; or
- Reliability, or
- Quality

Note: The research is not qualified research if its purpose relates to style, taste, and cosmetic or seasonal design factors. IRC §. 41(d)(3)(B). The auditor should question the eligibility of qualified

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research on consumer product development activities where style and taste factors are a significant part of the product.

- For research to be considered "qualified", the Illinois R&D Credit contains an additional requirement in that the research activities must be conducted within Illinois.

If the taxpayer can document that the project or activity meets ALL four of the above requirements, then it will qualify for the research credit. Issue an EDA-70 for each project or activity requesting documentation and/or other information establishing that each project or activity satisfies the above requirements.

K. EXCLUDED ACTIVITIES

There is certain research, research related and non-research activities that are excluded from qualifying for the research credit even though they may meet the general requirements of IRC § 41(d)(1). The activities for which the credit is not allowed are contained in IRC § 41(d)(4). They include the following:

1. Research after Commercial Production;

   Any research conducted after the beginning of commercial production of the business component.

2. Adaptation of Existing Business Component;

   Any research related to the adaptation of an existing business component to a customer's requirement or need.

3, Duplication of Existing Business Component;

   Any research related to the reproduction of an existing business component (in whole or in part) from a physical examination of the business component itself or from plans, blueprints, detailed specifications, or publicly available information with respect to such business component.

4. Surveys, Studies, such as:

   - Efficiency surveys;
   - Activities relating to management function or technique;

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- Marketing research, testing or development (including advertising and promotions);
- Routine data collection; or
- Routine or ordinary testing or inspection for quality control.

5. Computer Software;

- Except to the extent provided in regulations, any software with respect to computer software which is developed by (or for the benefit of) the taxpayer primarily for internal use by the taxpayer other than for use in:

- An activity which constitutes qualified research; or a production process.

See separate section below on Internal Use Computer Software.

6. Social Sciences, Etc.

- Any research in the social sciences, arts, or humanities include the development of a new life insurance contract, a new economic model or theory, a new accounting procedure or a new cookbook.

7. Funded Research

- Any Research to the extent funded by any grant, contract or otherwise by another person or governmental entity. This would include any research performed on behalf of other persons if the taxpayer does not retain substantial rights in the research. REF: CFR § 1.41- 2(a)(3)(i) and 1.41-5(d)(2).

8. Research Conducted Outside Illinois

- For Illinois purposes, any research conducted outside of this state would be excluded.

L. INTERNAL USE COMPUTER SOFTWARE

The IRS has issued two position papers based on the decisions issued in Norwest Corp., et al. v. Commissioner and United Stationers Inc. v. United States that provide guidance in auditing “internal use computer software” research projects. Ordinarily, software that is developed by or for the benefit of the

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taxpayer primarily for internal use by the taxpayer does not qualify for the credit unless the software is for use as follows:

- In an activity which constitutes qualified research, or
- In a production process which meets the requirements of qualified research.

"Internal use computer software" defined as software developed by the taxpayer solely for its own internal business and management purposes. The software supports general and administrative functions such as payroll, bookkeeping, or personnel management or provides non-computer services such as accounting, consulting or banking services. The software must meet a "high threshold of innovation" to obtain the credit.

Research projects involving the development of "internal use computer software" **must** satisfy seven tests. The first four tests relate to all research and experimentation projects and the additional three tests were developed as part of the narrowing of the credit by the Tax Reform Act of 1986 for "internal use computer software". The first four tests were explained in the Review of Projects section.

- The Section 174 Test
- The Discovery Test
- The Business Component Test
- The Process of Experimentation Test
- The Innovativeness Test

The innovativeness test requires that the software be innovative "as where the software results in a reduction in cost, or improvement in speed, that is substantial and economically significant".

- The Significant Economic Risk Test

The significant economic risk test requires that the software development involve significant economic risk "as where the taxpayer commits substantial resources to the development **and** there is substantial uncertainty, because of technical risk, that such resources would not be recovered within a reasonable period".

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- The Commercial Availability Test

The commercial availability test requires that the software not be commercially available for use by the taxpayer "as where the software cannot be purchased, leased or licensed and used for the intended purpose without modifications that would satisfy tests 5 and 6".

The following two court cases have further defined the eligibility of "internal use computer software" for the credit for increasing research activities:

1. **United Stationers Inc. v. United States** – The United Stationers case dealt with eight software projects in which the taxpayer claimed credits for increasing research activities in developing various software projects for use in its office supply wholesale business. The case was decided in favor of the Internal Revenue Service. The taxpayer argued that the projects were not internal use software that is excluded from the credit because their customers had access to and benefited from the programs. The court stated that in viewing the projects in totality the taxpayer's programs were the types of internal use software that Congress meant to exclude from the research credit. The projects were developed to help the taxpayer track its huge inventory. There was limited customer access to the programs, but that access was a benefit to the taxpayer in aiding in streamlining its operation.

   After concluding that the software development was for internal use, the court denied the research credit because the projects did not meet all the 3 internal use software tests. The program development did not discover information that was technological in nature. The projects did not define or expand the principles of computer science but instead modified the taxpayers existing software to improve its inventory control system. Also, the software development did not involve a process of experimentation as envisaged by Congress. There was no technical uncertainty about the program development from the onset. In other words, there was no doubt that the programs could be developed.
   REF: United Stationers, Inc. v. United States, 982 F. Supp. 1279 (N.D. Ill. 1997)

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2. **Norwest Corporation and Subsidiaries v. Commissioner of Internal Revenue** – The taxpayer, a Bank Holding Company, has affiliates that provide banking and other financial services. They developed or modified previously developed software for the internal management and administration of their businesses. The taxpayer had concluded that 67 of its 118 internal use software development activities qualified for the federal credit for increasing research activities. The IRS and the taxpayer selected eight software projects to serve as representative or sample activities to determine whether all or part of the 67 projects constituted qualified research for purposes of the tax credit. They also agreed that for the representative internal use software activities to constitute qualified research for purposes of the tax credit, all the seven tests must be satisfied.

   The tax court ruled that the three additional tests for qualified research in the development of internal use software enunciated in the conference report accompanying the TRA 1986 require a higher threshold of technological advancement and functional improvement than is necessary in other fields of research. One of the eight activities, the development of the strategic banking system's (SBS) customer module, satisfied all seven tests.

   The SBS discovered technological information by creating a customer-based system that could interact with other systems and handle large data amounts. Provided an improved taxpayer business component as to customer service and growth; involved an experimentation process by developing, testing and analyzing various approaches; was an innovative effort with potential for significant efficiency and economic benefits; involved significant economic risk due to its size and complexity; and was not commercially available when implemented. This software development project was a concerted effort at advancing the state of technology in the field of computer science and pushed existing technology to new heights in the opinion of the court. The remaining seven activities failed to satisfy the technical risk requirement of the significant economic risk test.
   REF: Norwest Corporation v. Commissioner, 110 T.C. 454 (1998)

M. IRS COORDINATED ISSUE PAPERS

The Internal Revenue Service issued two position papers on August 26, 1999 to provide guidance on auditing the Research Credit for federal purposes. These two papers will also be helpful in reviewing internal use software projects for Illinois purposes.

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1. UIL 41.51-10 – INTERNAL USE SOFTWARE

This paper deals with a taxpayer's activities related to the installation, customization, enhancement, and maintenance of a vendor-supplied software package and whether the costs incurred in this endeavor qualify for the Research Tax Credit.

The taxpayer purchased an administrative software package that was used by various competitors. The package provided an extensive list of standard features and provided the basic functions that the taxpayer needed. During the next 5 or 6 years, the taxpayer installed the package and initiated over 40 projects to maintain, customize and develop the system for use in its business. The software package was acquired for increasing corporate efficiency and reducing costs.

Before evaluating the projects for the three internal use software tests, the projects must meet the 4 tests for determining if the requirements for qualified research are met. Next it must be determined if the computer software has been developed by or for the benefit of the taxpayer primarily for its own use.

Once it was determined that the taxpayer for its own use developed the software, the three internal use software tests need applied.

a) **The Innovativeness Test** – The taxpayer had to show that it attempted to develop software that was innovative. The use of the software had to result in a reduction in cost, or improvement in speed that was substantial and economically significant. This can be demonstrated by the advantage that the taxpayer would gain over its competitors. In this case, the taxpayer reduced costs by 80%. However, this cost savings was not economically significant because it did not result in a competitive benefits or advantage. The software was new to the taxpayer but not new to the industry. Therefore, the taxpayer did not meet the first test.

b) **The Significant Economic Risk Test** – In order to satisfy this test, the taxpayer must show that the software development activities involved significant economic risk. Substantial resources must be committed to the development of the project and there is a substantial uncertainty because of the technical risk that the resources would be recovered within a reasonable period. To determine if the taxpayer has committed substantial resources to the software development, the following evaluation must be made:

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- Compare the amount of money spent versus the taxpayer's net assets;

- Compare the number of hours that the computer programmers spent on the projects versus the total time spent on software development;

- Compare the amount paid or budgeted for the software project to the total annual information technology budget;

- Compare the amount paid or budgeted for the software project compared to the amount paid or budgeted for all its research projects during the same period;

- Determine the level of management approval, if any, required under its budgetary procedures before it committed funds to the project to the extent that the approval process defines the taxpayer's own assessment of what is a substantial commitment of resources.

The activities cited in this position paper did not meet the Significant Economic Risk Test because the taxpayer spent less than 1% of its net assets over the life of the projects, there was no uncertainty that the resources would be recovered, the taxpayer's programmers completed the tasks using standard software development techniques.

This position paper elaborates on the difference between a technical risk and a business risk. Substantial uncertainty for purposes of the "substantial economic risk test" is caused by technical risk, not business risk. Seven of the eight projects in the Norwest case failed the Significant Economic Risk Test because they incurred a business risk not a technical risk. The following examples illustrate this point:

A technical risk arises when there is some question whether the software can be developed. A business risk arises when there is a question whether the software once developed will achieve the desired efficiency and cost savings.

If there is substantial uncertainty that the taxpayer can recover the resources expended within a reasonable period, this is a technical risk. Whether or not the taxpayer can complete the project on time and within budget is a business risk.

Since evaluating a technical risk versus a business risk is more difficult than determining if the taxpayer committed substantial resources, the Auditor may want to test the amount of resources committed to the activity before

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evaluating the risks. If the taxpayer fails to have committed substantial resources to an activity, it would fail the Significant Economic Risk Test.

c) **The Commercial Availability Test** – In order to satisfy the commercial availability test, the taxpayer must show that the software it developed was not commercially available as where the software cannot be purchased, leased or licensed and used for the intended purpose without modifications that would satisfy the first two requirements of the three-part test. Since the modifications made by the taxpayer to the purchased software package did not meet the first two tests, the commercial availability test was not met.

2. UIL 41.51-11 – QUALIFIED RESEARCH

This paper addresses the requirements for qualified research as to a specific business component and provides analysis that should be useful in determining what is qualified research.

The taxpayer, a kitchen designer and manufacturer, developed a new and improved toaster with a new “high tech” appearance that contained a new heating element. The taxpayer claimed all the costs of the development of the toaster as qualified research expenses. However, the requirements for qualified research will be applied to each business component of the taxpayer.

For purposes of this illustration, the first business component is the improved toaster. For the development costs of the entire toaster to qualify for the credit, the research activities in relationship to the toaster must meet the four tests. The development of the toaster did not meet the **discovery test** because all toasters in the taxpayer’s product line contained heating elements. In addition, the **process of experimentation test** was not met because there was no uncertainty that the heating element could be integrated into the toaster. The costs to give the toaster a high-tech appearance would not be considered for the credit because activities relating to style, taste, cosmetic, etc. do not qualify.

Since the toaster viewed did not qualify for the credit, the “shrinking back” rule applies. The most significant subset of elements of the original business component should be tested to see if all the tests are met by the development of the subset. In this case, the new heating element will be treated as a separate business component. When all the four primary research and development tests were applied to the development of the new heating element, the requirements for qualified research were met.

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The expenditures qualified under IRC § 174. The development of the material used in the new heating element involved discovery of information that was technological in nature and the application was useful in the development of the new product. The new heating element gave the toaster an enhanced performance because it heated up and cooled down more quickly than other heating elements. The process of experimentation test was met because the taxpayer was uncertain about the outcome and had to experiment to find a material to achieve the desired result.

Therefore, the costs of developing the new heating element qualified for the research credit.

In relation to internal use software, a total software development project may not qualify for the credit but if the shrink back rule is applied, a component of the project may meet all the tests.

N. REVIEW OF EXPENSES

1. **Request A Written Description of Each Cost Center** - If the taxpayer computes the credit under a cost center or department approach, request the written description or profile of the function of that cost center or department. Often, the description of the cost center or department will indicate that there are administrative or other non- qualified services being performed which should be disallowed. Pay special attention to cost centers or departments included in the computation of the research credit which are considered "outside" research and development such as manufacturing. If a written description is not available, request a narrative explaining the function of each cost center or department included in the computation of the credit.

2. **Request A Written Description of Each Account** - Regardless the methodology the taxpayer used to compute the credit, request a written description of each account included in the calculation of the credit. These descriptions should identify the function for each account. By reviewing the description or profile of each account, the auditor may find non- qualified accounts such as fringe benefits, travel, capital assets, etc. included in the computation of the credit.

3. **Examine the Wage Component of the Research Credit** - The term "wages" has the same meaning for purposes of this credit as it does for federal withholding purposes. In the case of a self-employed individual, the term "wages" includes the earned income of the individual as defined in IRC § 401(c)(2). The term " wages" does not include any amount

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considered in determining the targeted jobs credit under IRC § 51(a). REF: IRC § 41(b)(2)(D). However, the term "wages" does include any wages of eligible employees for which the Illinois Jobs Tax Credit could be or is claimed. Jobs Tax Credit has since been repealed. Only the wages of employees performing qualified services would constitute qualified research expenses. IRC § 41(b)(2)(B) defines the "Qualified Services" as:

- Engaging in the actual conduct of qualified research. For instance, a scientist conducting laboratory experiments would be performing a qualified service if the research being conducted were qualified. REF: IRC § 1.41-2(1), or

- Engaging in the direct supervision or direct support of research activities, which constitute qualified research.

  (i) Direct Supervision - Direct means the immediate supervision (i.e. first-line management) of qualified research. For instance, a research scientist who directly supervises laboratory experiments, but who may not actually perform the experiments would be considered involved in direct supervision of research activities. The term "direct supervision" does NOT include supervision by a higher-level manager to whom first-line managers' report even if that higher-level management is a research scientist. REF: IRC Regulation § 1.41-2(2).

  (ii) Direct Support - means services performed in the direct support of persons engaged in qualified research or persons who are directly supervising persons engaged in qualified research. For instance, direct support of research would include the services of a:

    - Secretary for typing reports describing laboratory results derived from qualified research

    - Laboratory worker for cleaning equipment used in qualified research

    - Clerk for compiling research data

    - Machinist for machining a part of an experimental model used in qualified research

    The term "direct support" does NOT include general administrative services, or other services only indirectly of benefit to research

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activities. Types of services, which would NOT be considered "direct support" services, would include the services of:

- Payroll personnel responsible for preparing salary checks of laboratory scientists
- An accountant for accounting for research expenses
- A janitor for general cleaning of a research laboratory
- Officers engaged in supervising financial or personnel matters
- Higher-level management

The fact that general administrative personnel are considered a part of a research department does not make their activities "direct support" of qualified research. REF: CFR § 1.41-2(c)(3).

Break down the wage component of the credit by individual employees. Identify each employee by name, job title, total wage and wage included in the credit. At a minimum, employees with questionable job titles and duties such as administrative, manufacturing, managerial, etc. The Human Resource or personnel department of the taxpayer may be able to assist you with obtaining the job descriptions and employee evaluations.

Items not considered qualified wages:

- Payments to a deferred compensation plan or trust such as an IRC § 401(k) plan and matching employer's contributions;
- Employee fringe benefits and other compensation not considered wages under IRC § 3401(a). AS A GENERAL RULE, ANYTHING NOT SUBJECT TO WITHHOLDING WOULD NOT BE CONSIDERED QUALIFIED WAGES FOR THE R&D CREDIT; and
- If an employee has performed both qualified services and non-qualified services, only the amount of wages allocated to the performance of qualified services constitutes an in-house research expense. In the absence of another method of allocation that the taxpayer can demonstrate to be more appropriate, the amount of in-house research expenses shall be

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determined by multiplying the total amount of wages paid to or incurred for the employee during the taxable year by the ratio of the total time actually spent by the employee in the performance of qualified services for the taxpayer to the total time spent by the employee in the performance of all services for the taxpayer during the taxable year. REF: CFR § 1.41- 2(d)(1).

- If, however, "substantially all" of an employee's wages are incurred for the performance of qualified services for the employer, then all the employee's wages for the taxable year will be considered to constitute in-house research expenses. "Substantially all" of an employee's wages will be from qualified services for the employer if ratio described above equals or exceeds 80%. REF: IRC § 41(b)(2)(B) and CFR § 1.41-2(d)(2).

4. **Review the Accounts Claimed as Qualified Supplies** - Supplies are tangible property other than land, land improvements, or property on which depreciation can be claimed. To be considered a qualifying supply, the item must be tangible property and totally used or consumed in the qualified research activity.

   Expenditures for supplies that are indirect research expenses or general and administrative expenses do not qualify. REF: CFR § 1.41-2(b)(1).

   In general, amounts paid for tangible utilities (such as water and natural gas) used in a building in which qualified research activities occur, will be considered general and administrative expenses and will NOT qualify for the credit. However, if a taxpayer can prove that the special character of the qualified research required additional extraordinary expenditures for tangible utilities, the amounts paid can constitute in-house research expenses. REF: CFR § 1.41-2(b)(2).

   Supplies should represent a small percentage of the credit. A review of the taxpayer's business should suggest a reasonable percentage of qualified supplies. Generally, supplies should only represent the costs to build prototypes. If a taxpayer is involved in heavy manufacturing, the supply cost will probably be greater than a taxpayer in light manufacturing. Software developers should be claiming little or no supply costs. Review the supply portion of the credit for non-qualified items often claimed as supplies such as capital assets, purchased software, utilities and travel expenses.

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5. **Time-Sharing of Computers** - For any amounts paid or incurred to another person for the right to use computers (time-sharing) in the conduct of qualified research to be considered an in-house research expense:

   The computer must not be owned by the taxpayer, must be located off the taxpayer's premises and the taxpayer must not be the primary user of the computer. REF: CFR § 1.41-2(b)(4).

   Also, for purposes of the Illinois credit, the computer must be in Illinois.

   However, any amount which qualifies under this provision must be offset by any amount the taxpayer (or any member of the unitary group) receives as income for the right to use substantially identical property. IRC § 41(b)(2)(A)(iii). For example:

   Corporation A conducts qualified research and pays Corporation B for the use of its computer. Corporation B conducts qualified research and pays Corporation A for the use of its computer. These expenses ordinarily would be qualified and eligible to be included in the credit computation. However, both Corporations received income for the use of their computers, which offset their expenses. Therefore, they cannot include the expense for the use of the other corporation's computer in the credit computation.

6. **Review the Contract Research Portion of Research Credit** - A "contract research expense" is 65% of any amount the taxpayer pays or accrues to any person not an employee of the taxpayer for qualified research or for services performed which would, if performed by an employee of the taxpayer, constitute qualified services on behalf of the taxpayer. If some of the services performed are qualified and others are not, only 65% of the amount paid for the qualified services will be eligible for the R&D Credit. REF: CFR §1.41-2(e)(1).

   An expense is a qualified contract research expense only if it is paid or incurred for the performance of qualified research pursuant to an agreement that:

   - Is entered prior to the qualified research being performed;
   - Provides that research be performed on behalf of the taxpayer; and
   - Requires the taxpayer to pay for the research even if it is not successful.

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If payment is contingent upon the success of the research, then the expense is considered payment for the product or result rather than for the performance of the research and the expense is not a qualified contract research expense. REF: CFR §1.41-2(e)(2).

Qualified research is performed "on behalf" of the taxpayer only if the taxpayer has a right (although not necessarily an exclusive right) to the research results. REF: CFR §1.41-2(e)(3).

If contract research expenses paid or incurred during the taxable year are attributable to qualified research to be conducted after the close of the taxable year (prepaid expenses), such amounts would be treated as paid or incurred during the period during which the qualified research is conducted. REF: CFR §1.41-2(e)(4).

IMPORTANT: Contract Research must be performed in Illinois; however, the contractor does not have to be in Illinois. The contracts should be reviewed to determine if the research is conducted in Illinois. Even if the company has a 100% Illinois factor, this does not mean that the contract research is conducted in Illinois. The possibility exists that you might have to prorate the contract, based on what was conducted within Illinois.

O. INTERCOMPANY TRANSACTIONS BETWEEN UNITARY GROUP MEMBERS

For corporations who are members of a unitary group filing a combined Illinois return, transfers (or charges) between members of the combined return are generally disregarded for purposes of the R&D Credit.

If one member performs qualified research in Illinois on behalf of another member, the member performing the research will include in its qualified research expenses any in-house research expenses for the work. The member for whom the research is performed will not treat any part of any amount paid or incurred as a contract research expense.

If one member pays or incurs contract research expenses to a person outside of the group for costs incurred in carrying on another member's trade or business, the contract research expenses will still be eligible for the R&D Credit IF the member who is carrying on the trade or business to which the research relates reimburses the member who paid the expenses. REF: CFR § 1.41-8(e).

P. BASIC RESEARCH PAYMENTS

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The term "qualifying expenditures" includes basic research payments. "Basic research payments" are defined in IRC § 41(e)(2) as any amount paid in cash during the taxable year by the taxpayer to any qualified organization for basic research if:

Such payment is pursuant to a written agreement between the taxpayer and the qualified organization; and

Such basic research is performed by the qualified organization. There is an exception to the requirement that research be performed by the organization in the case of scientific tax-exempt organizations and certain grant organizations. REF: IRC § 41(e)(2)(B)

A request should be made for a list of all contracts with research vendors. The list should be reviewed, and the contracts selected for the vendors that show audit potential. Request all agreements concerning the contracts. The contract must be reviewed to determine the following:

1. Who is at risk? Only the person who bears the risk of loss is entitled to the credit if the activity qualifies;

2. Who obtains substantial rights to the research? Only those who obtain the rights to the research may claim the credit; and

3. The specific activities performed by the contract researcher must be reviewed to determine if all activities constituted qualified research. It is possible that an allocation may be required to eliminate the non-qualified activities from the credit calculation.

These examples are based on examples provided in CFR §1.41-2(e)(5).

Example 1:

Corporation A is a calendar year taxpayer. In 2010 Corporation A enters into a contract with Corporation B to perform qualified research in Illinois on behalf of Corporation A. The contract requires Corporation A to pay Corporation B $300,000 for the research, regardless of its success. During 2010 Corporation B performs all the research and Corporation A pays Corporation B $300,000. $195,000 (65% of $300,000) is considered a contract research expense for purposes of the R&D Credit.

Example 2:

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Corporation C is a calendar year taxpayer who conducts qualified in-house research in Illinois in carrying on its trade or business. During 2010, Corporation C contracts with Corporation D, a temporary services agency, and pays Corporation D $400 for D to provide the services of a secretary for one week. The secretary spends the entire week typing reports describing laboratory results derived from C's qualified research.

These services, if performed by an employee of Corporation C, would constitute qualified services. Therefore, 65% of the amount paid to Corporation D, or $260 would constitute contract research expenses for purposes of the R&D Credit.

Example 3:

Corporation E is a calendar year taxpayer who conducts in-house qualified research in Illinois. During 2010, Corporation E contracts with an outside accounting firm to keep Corporation E's books and records pertaining to a specific research project. Corporation E agrees to pay the firm $100,000 for their services.

The activity conducted by the accounting firm would not constitute qualified services if an employee of Corporation E were performing it since general administrative services are not qualified services. Therefore, none of the $100,000 paid to the accounting firm would qualify as contract research expenses for the R&D Credit.

Q. START UP OR SPIN OFF COMPANIES

If a new company is formed and begins performing qualified research in the first year of operation, the taxpayer will have base period expenses of zero for each of the three preceding years prior to the start of operations. In the second year of operation, it will have two base period years with zero qualified expenses and one with the qualified expenses claimed the first year of operation, etc. (Federal Regulation 1.41-3)

R. OWNERSHIP CHANGES / ACQUISTITIONS & DISPOSSITIONS

If a company is formed because of a spin-off of a portion of a taxpayer's business, the new company will be considered a viable trade or business and will not qualify as a start-up company for R & D Credit purposes. It states under IRC § 41(f)(3)(A)

1. Acquisitions

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Taxpayer acquires the major portion of a trade or business of another person (hereinafter in this paragraph referred to as the "predecessor") or the major portion of a separate unit of a trade or business of a predecessor. Then, for purposes of applying this section for any taxable year ending after such acquisition happens, the amount of qualified research expenses paid or incurred by the taxpayer during periods before such acquisition increases by the amount expenses paid, incurred by the predecessor with respect to the acquired trade, or business as is attributable to the portion of such trade or business or separate unit acquired by the taxpayer. The gross receipts for the period increase by the amount gross receipts of such predecessor with respect to the acquired trade or business as is attributable to such portion.

This section prevents a taxpayer who begins business by buying and operating an existing company; from getting a credit if the amounts of qualified research expenses are not increased. The spun-off company must include its base period expenses for that division. The seller must provide that information to the spun-off company as explained below.

2. Dispositions:

If a taxpayer disposes of a major portion of a business, it should reduce its research expenses for periods prior to the date of disposition by the expenses of that business segment. This allows a taxpayer that operates two or more business, to sell one of the businesses and still be able to claim research and development credit on the business units that remain. REF: IRC § 41(f) (3) (B) However the seller does not get to reduce its predisposition expense amounts unless the seller gives the buyer the information that it needs to increase its base period amounts. REF: IRC § 41(f)(3)(B)(ii)

IAC 100.5270(d)(5) contains rules and examples for adjusting the base period for changes to the members of a combined group.

Example:

Company A, a farm machinery manufacturer, has a division that engineers and manufactures small farm tractors. This division conducted qualified research for which it had qualified research expenses. These qualified research expenses were included with Company A's total qualified research expenses as follows:

	Year	Company A	Small/Trac
Qualified research expenses	12/08	10,000,000	1,000,000

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	12/09	15,000,000	2,000,000
	12/10	17,000,000	2,500,000

On January 1, 2011, Small/Trac was spun off and sold to Company B. The base period for Small/Trac's YE 12/11 determination year will include the qualified expenses of Company A, which are attributable to Small/Trac in the base period.

	Qualified Expenses
Year End 12/08	1,000,000
Year End 12/09	2,000,000
Year End 12/10	2,500,000
Total of the Base Period Yrs.	5,500,000
Average of Base Period	1,833,333
Qualified Expenses 12/11	3,000,000
YE 12/11 Exp. minus Base Period Average	1,166,667
Credit Allowable	75,833

S. BASE PERIOD RECOMPUTATION

1. IN-STATUTE BASE PERIOD

In computing, the R & D credit for the determination year, the auditor/taxpayer may recalculate each year in the base period to reflect the correct qualified expenditures. If the statute of limitations has not expired for a base period year, the credit should be recomputed for that year to reflect the proper computation of qualified expenses, even if that year is outside the audit period.

Example

Your audit period is 2011 (the determination year). The base period is 2008, 2009, and 2010.

Statutes of limitations are still open for the base period of 2009 through 2010.

The wage expense as reported for 2008 through 2011 included the salary of the CEO, which does not qualify for the credit as follows:

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2008 - $50,000, 2009 - $80,000, 2010 - $90,000, 2011 - $100,000.

The auditor will decrease the wage expenses by the CEO's salary for each year and recompute the credit in the determination year of 2011. The credit should also be recomputed for each of the base period years for which the statute of limitations is still open.

T. RECOMPUTATION OF BASE PERIOD IN OUT OF STATUTE BASE PERIOD YEARS

To compute the qualified expenditures for the base period when the statute of limitations has expired for one or more of those years, the following procedures have been established by the Bureau of Audits.

1. If the qualified expenditures were understated for any base period year, the correct amount should be determined for purposes of computing the credit in any open year.

2. If the qualified expenditures were overstated for any closed base period year, and no credit was claimed for that year, the correct amount should be determined for purposes of computing the credit in any open year.

3. If the qualified expenditures were overstated for any closed base period year, and a credit was claimed for that year, the credit for any open year must be computed using the amount of expenditures claimed in computing the credit for that year under the duty of consistency. The duty of consistency prevents a taxpayer from receiving a double benefit from treating an item differently in a closed year from the way it treats the item in an open year. The duty of consistency was applied to the computation of the R&D credit in PLR 9040002. That PLR was overruled by Congress, which enacted IRC § 41(c)(6) in 1989, to require the recomputation of base period expenses to match the credit year computation in all cases. Treas. Reg. Section 1.41-3(d) states that IRC Section 41(c)(6) applies only to tax years beginning after December 31, 1989, indicating that the IRS would still apply the duty of consistency to earlier years. Because the IITA contains no similar provision, the duty of consistency should apply to all Illinois income tax cases.

   Example 1

   The taxpayer claimed the following qualifying expenses in the base period and the determination year:

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	12/08	12/09	12/10	12/11
Expenses	1,000,000	1,100,000	1,200,000	1,500,000

Total Base Period Expenses	=	$3,300,000
Average Expenses	=	$1,100,000
Qualified Expenses for YE 12/11	=	$1,500,000
Excess Expenses over Base Period	=	$ 400,000
Excess Expenses Times Rate (6.5%)	=	$ 26,000

The taxpayer has identified additional qualified expenses in 12/11 of $100,000 that is equal to an increase in the credit of $6,500. To quickly estimate the tax effect if we recomputed the base period, we would take the change in the base period expenses and divide that amount by 3 to determine an average change and compare it to the change in expenses in the determination year.

For example, the proposed changes to the base period is as follows:

12/08	12/09	12/10
50,000	75,000	90,000

The total of the changes for each year divided by 3 equals $71,666. ($50,000 + $75,000 + $90,000 = $215,000/3)

The change in expenses for YE 12/11 of $100,000 minus $71,666 equals $28,334. The tax effect if the base period were recomputed would be an increase in the credit by $1,842 instead of $6,500. The Auditor and Supervisor would need to evaluate whether the change in the credit is worth the audit hours and effort necessary to review the required records needed to recompute the base period.

Example 2

To accomplishes the application of the duty of consistency, the following example should be followed.

> All years are closed, and the credit claimed for 2010 and 2011 cannot be recaptured. Therefore, the entire amount of the credit is frozen. The qualifying expenditures claimed on the original returns are as follows:
> This example is much more complicated than it needs to be. Since 2008 and 2009 are out of statute and the credits claimed in those years were used in those years, the computation of the credit for any

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year in which 2008 or 2009 is one of the base years must treat the qualified expenditures claimed for one of those years as the minimum expenditure for that year. If the taxpayer overstated qualifying expenditures in that year, the amount it claimed must be used. If it understated qualifying expenditures for that year, the correct amount must be used.

QUALIFYING EXPENDITURES					
PERIOD	12/05	12/06	12/07	12/08	12/09
Per Return	$60,000	$70,000	$80,000	$106,000	$186,500
Per Audit	57,000	63,000	73,000	96,000	171,500

CREDIT EARNED AND USED PER RETURNS AS FILED		
BASE PERIOD EXPENDITURES	12/08	12/09
3rd Prior Return	$ 60,000	$ 70,000
2nd Prior Return	70,000	80,000
1st Prior Return	80,000	106,000
Total	$210,000	$256,000
Average	$ 70,000	$ 85,333
CURRENT YEAR EXPENDITURES	$106,000	$186,500
CREDIT BASE	$ 36,000	$101,167
(Current year expenditures - Average)		
CREDIT RATE	6.5%	6.5%
CREDIT EARNED	$ 2,340	$ 6,576
TAX	$ 1,600	$ 6,600
AVAILABLE CREDIT		
CREDIT CARRYOVER FROM PRIOR YEAR(S)	$ 0	$ 740
CURRENT CREDIT	$ 2,340	$ 6,576
TOTAL AVAILABLE CREDIT	$ 2,340	$ 7,316

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CREDIT APPLIED	$ 1,600	$ 6,600
TAX DUE	$ 0	$ 0
CREDIT EARNED AND USED THIS YEAR	$ 1,600	$ 5,860
CARRYOVER TO SUBSEQUENT YEAR	$ 740	$ 716
CREDIT USED IN 1ST YEAR	$ 740	$ 0
TOTAL CREDIT USED	$ 2,340	$ 5,860
(Credit Earned and Used Plus Carryover Used)		

RECOMPUTATION BY AUDIT		
CREDITS WHICH CANNOT BE RECAPTURED		
	12/08	12/09
USED IN YEAR EARNED	$ 1,600	$ 5,860
USED IN SUBSEQUENT CLOSED YEAR	$ 740	$ 0
TOTAL "FROZEN" CREDITS	$ 2,340	$ 5,860

RECOMPUTATION OF CREDIT BASE USING EXPENDITURES PER AUDIT		
	12/08	12/09
Base Period Expenditures		
3rd Prior Return	$ 57,000	$ 63,000
2nd Prior Return	63,000	$ 73,000
1st Prior Return	73,000	*$100,333
Total	$193,000	$236,333
Average	$ 64,333	$ 78,778
"Frozen" Credits	$ 2,340	$ 5,860
Credit Rate	6.5%	6.5%
"Frozen" Credit Base	36,000	90,154
("Frozen" Credits Divided by Rate)		
Tentative "Frozen" Expenditures	$100,333	$168,932
(Average Exp + "Frozen" Credit Base)		

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Actual Expenditures Per Audit	$ 96,000	$171,500
*"Frozen" Expenditures (The Greater of Actual Expenditures or Tentative "Frozen" Expenditures)	$100,333	$171,500
Credit Base	$ 36,000	$ 92,722
("Frozen" Expenditures - Average)		
Credit Rate	6.5%	6.5%
Recomputed Credit Earned	$ 2,340	$ 6,027
Corrected Carryover to Subsequent Year	$ 740	$ 167

*(This amount is used in the computation of the subsequent year's base period)

Example 3

All years are closed, and the credit cannot be recaptured except for YE 12/09. Therefore, the credit claimed for YE 12/03 through 12/08 is frozen.

QUALIFYING EXPENDITURES							
PERIOD	12/03	12/04	12/05	12/06	12/07	12/08	12/09
Per Returns	$60,000	$70,000	$80,000	$106,000	$186,500	$260,000	$300,000
Per Audit	$57,000	$63,000	$73,000	$ 96,000	$171,500	$240,000	$280,000

CREDIT EARNED AND USED PER RETURNS AS FILED				
	12/06	12/07	12/08	12/09
Base Period Expenditures				
3rd Prior Return	$ 60,000	$ 70,000	$ 80,000	$106,000
2nd Prior Return	$ 70,000	$ 80,000	$106,000	$186,500
1st Prior Return	$ 80,000	$106,000	$186,500	$260,000
Total	$210,000	$256,000	$372,500	$552,500
Average	$ 70,000	$ 85,333	$124,167	$184,167
Current Year Expenditures	$106,000	$186,500	$260,000	$300,000

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Credit Base	$ 36,000	$101,167	$135,833	$115,833
(Current Year Expenditures Minus Average)				
Credit Rate	6.50%	6.50%	6.50%	6.50%
Credit Earned	$ 2,340	$ 6,576	$ 8,829	$ 7,529
Tax	$ 1,600	$ 6,600	$ 7,900	$ 8,000
Available Credit				
Credit Carryover from Prior Year(s)	$ 0	$ 740	$ 716	$ 1,645
Current Credit	$ 2,340	$ 6,576	$ 8,829	$ 7,529
Total Available	$ 2,340	$ 7,316	$ 9,545	$ 9,174
Credit Applied	$ 1,600	$ 6,600	$ 7,900	$ 8,000
Tax Due	$ 0	$ 0	$ 0	$ 0
Credit Earned and Used This Year	$ 1,600	$ 5,860	$ 7,184	$ 6,355
Credit Available for Carryover	$ 740	$ 716	$ 1,645	$ 1,174
Used in 1st Subsequent Year	$ 740	$ 716	$ 1,645	$ 0
Used in 2nd Subsequent Year	$ 0	$ 0	$ 0	$ 0
Used in 3rd Subsequent Year	$ 0	$ 0	$ 0	$ 0
Used in 4th Subsequent Year	$ 0	$ 0	$ 0	$ 0
Used in 5th Subsequent Year	$ 0	$ 0	$ 0	$ 0
Total Carryover Used	$ 740	$ 716	$ 1,645	$ 0
Total Credit Used	$ 2,340	$ 6,576	$ 8,829	6,355
(Credit Earned and Used Plus Carryover Used)				

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RECOMPUTATION BY AUDIT				
Credit Which Cannot Be Recaptured				
	12/06	12/07	12/08	12/09
Used in Year Earned	$ 1,600	$ 5.860	$ 7,184	$ 0
Used in Subsequent Year	$ 740	$ 716	$ 0	$ 0
Used in 2nd Subsequent Year	$ 0	$ 0	$ 0	$ 0
Used in 3rd Subsequent Year	$ 0	$ 0	$ 0	$ 0
Total "Frozen" Credits	$ 2,340	$ 6,576	$ 7,184	$ 0

QUALIFYING EXPENDITURES						
PERIOD	12/04	12/05	12/06	12/07	12/08	12/09
Per Returns	$60,000	$70,000	$80,000	$106,000	$186,500	$260,000
Per Audit	$57,000	$63,000	$73,000	$ 96,000	$171,500	$240,000

RECOMPUTATION OF CREDIT BASE USING EXPENDITURES PER AUDIT				
Base Period Expenditures	12/04	12/05	12/06	12/07
3rd Prior Return	$ 57,000	$ 63,000	$ 73,000	*$ 100,333
2nd Prior Return	$ 63,000	$ 73,000	*$100,333	*$ 179,947
1st Prior Return	$ 73,000	*$ 100,333	*$179,947	*$ 240,000
Total	$193,000	$236,333	$353,280	$ 520,280
Average	$ 64,333	$ 78,778	$117,760	$ 173,427
"Frozen" Credits	$ 2,340	$ 6,576	$ 7,184	$ 0
Credit Rate	6.50%	6.50%	6.50%	6.50%
"Frozen" Credit Base ("Frozen Credits Divided by Rate)	$ 36,000	$ 101,169	$ 110,523	$ 0
Tentative Frozen Expenditures	$100,333	$ 179,947	$ 228,283	$ 0
Actual Expenditures Per Audit	$ 96,000	$ 171,500	$ 240,000	$ 280,000
Frozen Expenditures	*$100,333	*$ 179,947	$ 240,000	*$280,000

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*(The Greater of Actual Expenditures or Tentative "Frozen" Expenditures)				
Credit Base ("Frozen" Expenditures - Average)	$ 36,000	$101,169	$122,240	$106,573
Credit Rate	6.50%	6.50%	6.50%	6.50%
Recomputed Credit Earned	$ 2,340	$ 6,576	$ 7,946	$ 6,927
*(This amount is used in the computation of the subsequent year's base period.)				

Computation of Tax and Carryovers Per Audit				
	12/06	12/07	12/08	12/09
Pre-Credit Tax Per Audit	$1,600	$6,600	$7,900	$8,000
Credit Carryover to Current Year	$ 0	$ 740	$ 716	$ 762
Current Year Credit	$2,340	$6,576	$7,946	$6,927
Total Available Credit	$2,340	$7,316	$8,662	$7,689
Net Tax	$ 0	$ 0	$ 0	$ 311
Credit Earned and Used in this Year	$1,600	$5,860	$7,184	$6,927
Credit Available for Carryover	$ 740	$ 716	$ 762	$ 0
Used in 1st Subsequent Year	$ 740	$ 716	$ 762	$ 0

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Used in 2nd Subsequent Year	$ 0	$ 0	$ 0	$ 0
Used in 3rd Subsequent Year	$ 0	$ 0	$ 0	$ 0
Used in 4th Subsequent Year	$ 0	$ 0	$ 0	$ 0
Used in 5th Subsequent Year	$ 0	$ 0	$ 0	$ 0
Total Carryover Used	$ 740	$ 716	$ 762	$ 0
Total Credit Used	$2,340	$6,576	$7,946	$6,927

U. INFORMATION HELPFUL IN RESEARCH

A review of job descriptions and personnel reviews may give the auditor valuable information concerning the employees claimed for the credit. Additional information that may be available, which could help the auditor and the taxpayer support the research activities are as follows:

1. Organization charts or other similar documents describing the organization of the taxpayer. Organization charts should identify research personnel and where the research activities fit within the overall structure of the taxpayer. Reviewing the organization charts may identify the location of management and other administrative activities;

2. Accounting, financial, policy and other manuals that describe the research and development activity and the research tax credit. These should give the auditor a written description as to what the taxpayer included in the calculation of the research tax credit. This may not be needed if the taxpayer can explain to the auditor during the interview the methodology used to compile the accounts and numbers;

3. Materials explaining research activities, including brochures, pamphlets, press releases and other similar documents;

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4. Submissions to management, the Board of Directors, review committees or other similarly situated individuals regarding research projects, activities, expenditures and the research credit;

5. Documents prepared by or on behalf of internal audit, including quarterly and annual reports that refer in any manner to the research activities;

6. Applications regarding requests for patents and copyrights for research activities;

7. Minutes, notes or other similar recordings from budget, board of directors', managerial or other similar meetings concerning research activities. Also, memoranda requesting budgetary authority for the project;

8. Project authorization, budget or work order that initiates the research and experimental project;

9. The internal authorization policy required by the taxpayer to approve a research project;

10. Project summaries and/or progress reports and project meeting minutes; and

11. Field and Lab verification data.

Items 3 - 11 should be reviewed when the auditor considers the research activity. This information may assist you in understanding what projects the taxpayer was involved in during the examined years.

V. POTENTIAL ISSUES THAT SHOULD BE CONSIDERED WHEN EXAMINING THE RESEARCH CREDIT

Certain issues have been identified as **non-qualified activities or expenses.** After a review of the work papers and your interview with the taxpayer, you may be able to identify these specific issues. Identify the issue to the taxpayer and request the costs associated with the issue. The issues are as follows:

1. Technical writers and other individuals who prepared the end user manuals or other instructive documents for the end user. This is a coordinated issue;

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2. Payments to a deferred compensation plan or trust such as an I.R.C. Section 401(k) plan and matching employers' contributions;

3. Employee fringe benefits and other compensation not considered wages under IRC § 3401(a);

4. Managers above first line supervisors;

5. Purchased, licensed or leased software;

6. Utilities;

7. Overhead expenditures;

8. Travel; and

9. Research tax credit claimed on costs associated with the development of a generic drug.

XI. ENVIRONMENTAL REMEDIATION CREDIT

IITA §201(l) IAC §100.2163

For tax years ending after December 31, 1997, and on or before December 31, 2001, a taxpayer shall be allowed a credit against the tax imposed by IITA § 201(a) and (b) for unreimbursed environmental remediation costs incurred.

The credit is calculated using:

- Form IL-1299-D for Corporations and Fiduciaries
- Form IL-1299-C for Individuals
- Form IL-1299-A for Partnerships and S Corporation

The credit allowed shall be equal to 25% of the unreimbursed remediation costs incurred and approved by the Illinois Environmental Protection Agency more than $100,000 per cleanup site.

- The $100,000 deductible does not apply if the remediation site is within an enterprise zone. [IITA § 201(l)]

The credit is earned in the year the Illinois Environmental Protection Agency issues:

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No Further Remediation Letter with respect to the site and may not exceed $150,000 per site.

The credit is not allowed to a person who is responsible for the pollution of the remediation site or who is related to the responsible person. A person is related to a responsible person if deductions for losses incurred on transactions between them would be disallowed under IRC § 267(b), (c), or (f)(1). [IITA § 201(l)]

CARRYOVER OF EXCESS CREDIT

The credit (including carryforwards) may not exceed $40,000 per year and may not reduce the taxpayer's liability for the tax imposed by IITA § 201 (a) and (b) below zero. Any credit more than the tax liability either for the taxable year or the $40,000 per year limitation may be carried forward to offset the income tax liability of the taxpayer for the next 5 years or until it has been fully utilized, whichever occurs first.

1. Credit more than the $150,000 per site limitation may not be carried over to another year.

   a) If a credit from more than one year is carried forward to a tax year, the credit arising in the earliest tax year is applied first.

2. If the site is sold, any unused credit passes to the purchaser, unless the purchaser is disqualified under subsection (d) of this Section.

3. In the case of a credit earned by a partnership or Subchapter S corporation, the credit passes through to the owners for use against their regular income tax liabilities in the same proportion as other items of the taxpayer are passed through to its owners for federal income tax purposes.

Note: A taxpayer claiming the credit who has deducted any of the expenses on which the credit is based for federal income tax purposes must add those expenses back in computing base income. (Source: IITA Section 203(a) (2) (D-10), (b) (2) (E-5), and (c) (2) (G-5))

XII. EDUCATION EXPENSE CREDIT

IITA §201(m) IAC §100.2165

The parents or legal guardians of one or more qualifying pupils are allowed an income tax credit for expenses incurred on behalf of qualifying pupils equal to 25% of qualified education expenses.

- The maximum amount of the credit is $500 for tax years prior to December 31, 2017.

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- The maximum amount of the credit is $750 for tax years ending on or after December 31, 2017.
- No credit is allowed for any tax year beginning on or after January 1, 2017, to taxpayers with adjusted gross income more than $500,000 if married filing joint for federal income tax purposes or $250,000 for all other taxpayers

"Qualifying pupils" means full-time students enrolled in a kindergarten through grade 12 program at any public or non-public elementary or secondary school in Illinois. In addition, they are required to be under 21 years of age at the close of the school year for which a credit is sought. Qualifying expenses include tuition, book fees, and lab fees over $250 incurred on behalf of a qualifying pupil. See Regulation 100.2165 for more information.

EXCESS CREDIT

The credit may not reduce the taxpayer's liability to less than zero. Therefore, no part of the education expense credit is refundable. There is no provision for carryover of excess credits.

XIII. RIVER EDGE REDEVELOPMENT ZONE REMEDIATION CREDIT

IITA §201(n)

IITA § 201(n) provides a credit equal to 25% of unreimbursed eligible remediation costs more than $100,000 per site incurred to clean up sites within River Edge Redevelopment Zones

The credit is calculated using:

- Schedule 1299-D for corporations and fiduciaries

For tax years ending on or after December 31, 2006 and ends before July 12, 2016, allows for a credit on unreimbursed eligible remediation costs incurred in a Site Remediation Program under the Environmental Protection Act in a river edge development zone.

Any taxpayer cannot take the credit if:

- The taxpayer or any related party caused or contributed to a release of regulated substances on, in, or under the site at which the otherwise eligible remediation costs were incurred.

Note: The credit cannot be passed through by a partnership to its partners or by a subchapter S corporation to its shareholders.

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A. QUALIFICATIONS

To qualify for this credit, you must have:

1. Received approval of the eligible remediation costs from the Illinois Environmental Protection Agency (IEPA) on forms the IEPA will provide. The credit is 25 percent (.25) of the amount of unreimbursed eligible remediation costs that were:

   • More than $100,000;

   • approved by the IEPA; and

   • incurred in performing environmental remediation at a Site Remediation

2. Program site located within a river edge redevelopment zone for which a "No Further Remediation" (NFR) letter was issued by the IEPA during the taxable year and recorded by the recipient.

The seller must record the transfer of the credit in the chain of title of the site and notify the director of the Illinois Department of Revenue, in writing, of the intent to sell the remediation site and of the amount of credit to be transferred.

Note: In no event may a credit be transferred to any taxpayer if the taxpayer or a related party would not be eligible under the provisions of subsection (i) of IITA § 201 (n).

B. CARRYOVER OF EXCESS CREDIT

The taxpayer may carry any excess credit forward for five years following the year for which the credit first earned until it is used. This credit shall be applied first to the earliest year for which there is a liability. If there is a credit from more than one tax year that is available to offset a liability, the earliest credit shall be applied first.

Any unused credit and remaining carryforward period may be sold to a buyer as part of a sale of all or part of the remediation site for which the credit was granted.

XIV. COAL RESEARCH AND COAL UTILIZATION EQUIPMENT CREDITS

IITA §206 IAC §100.2170

IITA § 206 provides for two credits for Coal Research and Coal Utilization. The credits are available only to corporations and are applied against their Income Tax liability. The

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first credit is based on qualified donations made. The second credit is based on the amount spent on qualifying property placed in service during the tax year.

The credit is calculated using:

- Schedule 1299-D for corporations and fiduciaries

Until January 1, 2005, each corporation subject to the Illinois Income Tax Act shall be entitled to a credit against the tax imposed under IITA § 201(a) and (b) in the amount:

- Equal to 20% of the amount donated to the Illinois Center for Research on Sulfur in Coal (IITA § 206).

- Equal to 5% of the amount spent during the taxable year by the corporation on equipment purchased for maintaining or increasing the use of Illinois coal at any Illinois facility owned, leased or operated by the corporation. Equipment shall be limited to:

  - direct coal combustion equipment

  - pollution control equipment

For purposes of this credit, the amount spent on qualifying equipment shall be defined as the basis of the equipment used to compute the depreciation deduction for federal income tax purposes.

- This amount spent is the adjusted basis of each item of equipment as determined pursuant to IRC § 167(g). Generally, the adjusted basis will be the purchase price of the property plus any capital expenditures less any rebates (IITA § 206).

- To show that the equipment was purchased with the intent to maintain or increase the use of Illinois coal at any Illinois facility owned, leased or operated by the taxpayer,

- The taxpayer must demonstrate that the equipment was used for the combustion of Illinois coal during the taxable year or could reasonably have been so used but was not due to circumstances beyond the taxpayer's control.

CARRYOVER OF EXCESS CREDIT

- For credits earned in tax years ending on or after December 31, 1987, a 5-year carry-forward is allowed. It must be applied to the earliest year for which there is a liability.

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XV. TECH-PREP CREDIT

IITA §209

IITA § 209 provides a credit for expenditures for TECH-PREP programs. The credit is available only to taxpayers that are primarily engaged in manufacturing and is an offset against the taxpayer's income tax liability.

The credit is equal to 20% of direct payroll expenditures to teachers and students who are an employee of the taxpayer, provided that no credit can be claimed for an expenditure for which the training expense credit is claimed under IITA Section 201(j).

The credit does not flow through partnerships or S corporations.

The credit is calculated using:

- Schedule 1299-D for corporations and fiduciaries

A. TECH-PREP PROGRAMS

A TECH-PREP program is a cooperative secondary school youth vocational program in Illinois which has been certified by the State Board of Education and the Department of Revenue (See Note 1 below) because the program prepares students to be technically skilled workers and meets the performance standards of business and industry and the admission standards of higher education. REF: IITA § 209(a).

Note: PA 92-846 (approved August 23, 2002) removed the requirement that IDOR certify education programs. The State Board of Education already certifies programs that qualify.

This credit does not apply to those programs with national standards that have been or in the future are approved by the US Department of Labor, Bureau of Apprenticeship Training or any federal agency succeeding to the responsibilities of that Bureau. REF: IITA § 209(d).

B. RECORDKEEPING

A taxpayer claiming this credit must record, maintain and provide such information regarding its participation in a qualifying TECH-PREP program as certified by the State Board of Education or by regulations, requires. REF: IITA § 209(c).

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C. CARRYOVER OF EXCESS CREDIT

If the credit exceeds the amount of income tax liability for the year, the excess may be carried forward 2 years and applied to the earliest year for which there is an income tax liability. If there are credits from more than one tax year available to offset a liability, the earlier credit is applied first.

XVI. DEPENDENT CARE ASSISTANCE PROGRAM CREDIT

IITA §210 IAC §100.2195

IITA § 210 provides a credit for expenditures for qualifying dependent care assistance programs. The credit is available only to taxpayers primarily engaged in manufacturing and is an offset against the taxpayer's income tax liability. The credit is equal to 5% of the expenditures of the taxpayer that qualify under IRC Section 129(d)(7) for on-site day care facility at an Illinois workplace of the taxpayer. The credit cannot be claimed on expenditures for which the credit under IITA § 210.5 is claimed.

The credit does not flow through partnerships or S corporations.

The credit is computed using:

- Schedule 1299-D for corporations and fiduciaries.

A. DEPENDENT CARE ASSISTANCE PROGRAMS

To qualify for the credit the taxpayer must:

- Establish an on-site facility dependent care assistance program at an Illinois location of the taxpayer's workplace.
- The dependent care assistance program must qualify under IRC §129.
  - It is important to note that while a dependent care assistance program does not have to be established at an on-site facility to qualify under IRC § 129, it does have to be established at an on-site facility to qualify for the credit under IITA § 210.

B. IRC § 129

Defines a dependent care assistance program as one which is a separate written plan of an employer for the exclusive benefit of its employees to provide such employees with dependent care assistance which meets the requirements of

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subsections (2) through (8) of Section 129. If a plan would qualify but fails to meet any of the requirements of these subsections, it will still be treated as a dependent care assistance program in the case of employees who are not highly compensated employees.

Subsections (2) through (8) of IRC § 129(d) provide that the dependent care assistance program:

- Must not discriminate in favor of highly compensated employees and allow all employees who meet the plans requirements to be eligible to participate;
- No more than 25% of the amounts paid or incurred by the employer for dependent care assistance may be spent for the benefit of individuals who are shareholders or owners who individually own more than 5% of the stock or interest in the employer;
- Must provide reasonable notification of the availability and terms of the plan to all eligible employees;
- Must provide each participant with a statement of expenses incurred for the benefit of that participant for the calendar year; and
- Qualifies if the average benefits provided to other than highly compensated employees are at least 55% of the average benefits provided to highly compensated employees.

C. QUALIFYING EXPENDITURES

For an expenditure to qualify for this credit it must be reported pursuant to IRC § 129(d)(7). REF: IITA § 210. IRC § 129(d)(7) provides that any employer providing a dependent care assistance program to its employees must furnish each employee who is a part of the plan with a written statement showing the amounts paid or expenses incurred by the employer in providing dependent care assistance to that employee during the previous calendar year. The statement must be provided to the employee by January 1 of the following year.

D. CARRYOVER OF EXCESS CREDIT

If the credit exceeds the amount of income tax liability for the year, the excess should be carried forward two years; then applied to the earliest year for which there is an income tax liability. If there are credits from more than one tax year available to offset a liability, the earlier credit is applied first.

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XVII. TAX CREDIT FOR EMPLOYEE CHILD CARE

IITA §210.5 IAC §100.2196

Corporate taxpayers are entitled to a tax credit for the cost of providing a childcare facility to its employees located in Illinois.

The credit is an amount equal to:

For taxable years ending on or after December 31, 2000 and on or before December 31, 2004, and for taxable years ending on or after December 31, 2007.

- 30% of the start-up cost of providing a child care facility for the corporate taxpayer's employees

For taxable years ending on or after December 31, 2000

- 5% of the annual cost in providing such child care facility.
  - If this credit is claimed, the dependent care assistance program credit under IITA § 210, explained above, cannot also be claimed.
  - A corporate taxpayer may provide and operate a childcare facility independently or in partnership with other corporations.

Start-up costs mean planning, site preparation, construction, renovation, or acquisition of a childcare facility. The credit is limited to a childcare facility in Illinois.

CARRYOVER OF EXCESS CREDIT

Any excess credit may be carried forward to the next five taxable years. The credit must be applied against the earliest year first.

XVIII. ECONOMIC DEVELOPMENT FOR A GROWING ECONONMY (EDGE) CREDIT

IITA § 211 IAC § 100.2198

Public Act 91-476 created the Economic Development for a Growing Economy Tax Credit (EDGE Credit) Act. The credit is allowed for tax years beginning on or after January 1, 1999 for taxpayers that have entered into an agreement with the Department of Commerce and Economic Opportunity (DCEO, formerly the Department of Commerce and Community Affairs or DCCA). The credit is for businesses located within or planning to locate within Illinois.

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Each year, DCEO certifies the amount of credit earned by the taxpayer. When claiming the credit, the taxpayer must attach a copy of the certificate of verification received from DCEO to Form IL 1299-D.

According to 35 ILCS 10/5-5 the taxpayer or "applicant" must be engaged in the following interstate or intrastate commerce for:

- manufacturing, processing, assembling, warehousing, or distributing products,
- conducting research and development,
- providing tourism services, or
- providing services in interstate commerce, office industries, or agricultural processing.

Businesses not eligible for the credit include those that are engaged in "retail, retail food, health, or professional services".

To claim the credit, the taxpayer is required to enter into an agreement with DCEO, which states the conditions of the program and is subject to the following limitations:

1. The credit cannot exceed the incremental income tax, which is the total amount of Illinois income tax withheld during the tax year from the compensation of new employees who are employed at a project that is the subject of the agreement.

Note: Although the EDGE Act specifically limits the credit to withholding from new employees, DCEO awards the credit for retained employees as well. See DCEO regulation 14 IAC § 527.20.

2. The amount of the credit allowed during the tax year plus the total of all amounts allowed in prior years cannot exceed 100 per cent of the total amount spent on approved costs (defined in the agreement) by the taxpayer during all prior tax years.

   a) The allowable credit is determined on an annual basis and cannot extend beyond 10 years after the project is first approved and cannot extend beyond the expiration of the agreement.

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b) For a taxpayer certified by the DCEO under the Corporate Headquarters Relocation Act, the credit may not:

(1) Extend beyond 15 taxable years and may not

(2) Extend beyond the expiration of the Agreement;

(a) Provided, that such taxpayer may not claim for any tax year during such period more than 60% of the credit otherwise allowed for such tax year under the EDGETCA (EDGETCA § 5-45).

c) The amount of the credit cannot exceed the amount of income tax for the tax year.

d) In the case of a credit earned by a partnership or Subchapter S corporation, the credit passes through to the owners for use against their regular income tax liabilities in the same proportion as other items that are passed through for federal income tax purposes.

Note: It is the responsibility of the auditor to verify the taxpayer has only claimed the amount of credit allowed by DCEO on the certificate of verification.

- During the audit if there is a question on the status of a taxpayer's certification do not contact the agency directly; instead submit the inquiry and documentation to your supervisor.
- The information will be sent to Technical Support Supervisor, where it will be analyzed and presented to Legal for review.
- The Departments liaison will contact DCEO personnel directly if needed. The requested information will be given to the auditor by their supervisor.
- If a notice of non-compliance is received from DCEO establish the taxpayer's liability for the credit as if an erroneous refund per IITA § 905(g).

CARRYOVER OF EXCESS CREDIT

The excess credit can be carried forward for five years. The excess credit must be used in proportion to its share of the total excess credit available for the year in which the credit was earned.

Note: Section 5-15 of the EDGE Tax Credit Act (35 ILCS 10/5-15) provides that certain taxpayers may elect to claim the credit against the WIT obligation (IITA § 704A) in lieu of the taxpayer's income tax obligation. The election is made for the first calendar year beginning after the end of the tax year in which the credit is earned. Once made, the

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election may not be revoked. If a taxpayer is eligible to make this election, DCEO will indicate that eligibility on the credit certificate it issues to the taxpayer.

XIX. EARNED INCOME TAX CREDIT

IITA §212 IAC §100.2199

Beginning on or after January 1, 2017, the amount is 14% of the federal tax credit for taxable year 2017, and the amount is 18% of the federal tax credit for taxable year 2018. PA 100-22 effective 7-6-2017.

Beginning on or after January 1, 2013, the amount is 10% of the federal tax credit. (IITA § 212(a))

Beginning on or after January 1, 2012 and ending prior to December 31, 2012, the amount is 7.5% of the federal earned income tax credit allowed.

For taxable years beginning on or after January 1, 2000 and ending prior to December 31, 2012, an individual shall be allowed a credit against the tax imposed by IITA § 201(a) and (b) for the taxable year equal to 5% of the federal earned income tax credit allowed for such taxable year pursuant to IRC § 32.

For tax years beginning on or after January 1, 2003 if the amount of the credit exceeds the income tax liability for the applicable tax year, then the excess credit shall be refunded to the taxpayer. (IITA § 212(b))

For tax years beginning before January 1, 2003, the credit allowed for the taxable year may not reduce the taxpayer's liability under the IITA to less than zero. Therefore, no part of the credit is refundable in the event the tax liability of the taxpayer is reduced to zero. (IITA § 212(b))

In the case of a nonresident or part-year resident, the amount of credit shall be in proportion to the amount of income attributable to this State. (See IITA § 212(a).)

CARRYOVER OF EXCESS CREDIT

Excess credits that are not refundable may not be carried over to other tax years.

XX. FILM PRODUCTION SERVICES TAX CREDIT

IITA § 213 IAC § 100.2185

For taxable years Beginning on or after January 1, 2004

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To qualify for the credit, taxpayers must apply with the Department of Commerce and Economic Opportunity, providing information necessary to calculate the credit.

- The DCEO then issues the taxpayer the "Final Film Tax Credit Certificate" that indicates the amount of tax credit the taxpayer is eligible for.

- If the taxpayer is a partner in a partnership or Subchapter S corporation, the credit can flow through to the partners or shareholders in accordance with their distributive share of income.

CARRYOVER OF EXCESS CREDIT

Excess credit can be carried forward 5 years. The credit cannot reduce the taxpayer's liability to less than zero. The person earning the credit may transfer the credit within one year after the credit is awarded. The transfer is made through DCEO, which will issue a certificate to the transferee stating the amount transferred and, if the transferor retains some of the credit, a certificate stating the amount retained.

XXI. TAX CREDIT FOR AFFORDABLE HOUSING DONATIONS

IITA § 214 IAC §100.2190

Beginning with taxable years ending on or after December 31, 2001 until taxable year ending December 31, 2021

Taxpayers subject to tax under IITA § 201(a) or (b) making donations to certain affordable housing projects under Section 7.28 of the Illinois Housing Development Act (20 ILCS 3805/7.28) are allowed:

- A tax credit for those donations equal to 50% of the value of the donation.

Partners, shareholders of Subchapter S corporations, and owners of limited liability companies that are treated as partnerships are also entitled to the credit.

Persons or entities not subject to tax under IITA § 201(a) or (b) and who donate under the Illinois Housing Development Act are entitled to receive and to transfer a tax credit for affordable housing donations.

This credit can be transferred in either of two ways:

1. to the purchaser of land that has been designated solely for affordable housing projects in accordance with Section 7.28 of the Illinois Housing Development Act

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2. to another donor who has also made an eligible donation to the sponsor of an affordable housing project in accordance with the Illinois Housing Development Act.

If the credit may be claimed in the tax year in which the donation is made or in the tax year in which the administrative housing agency issues the reservation letter stating the amount of the credit allocated to the affordable housing project under 47 Ill. Adm. Code 355.209 (if it is later than the date of donation) or, in the case of a transferee, in the tax year of the transfer. Taxpayers claiming this credit are required to provide the following information with their Illinois Income Tax return concerning the credit they are claiming:

- for the taxable year for which the credit is allowed, a donor (or a partner or Subchapter S corporation shareholder of the donor) claiming the credit shall attach to its Illinois income tax return a copy of the reservation letter issued by the administrative housing agency stating the amount of the credit allocated to the affordable housing project under 47 Ill. Adm. Code § 355.209.

- for the taxable year in which a credit is transferred, the transferee (or a partner or Subchapter S corporation shareholder of the transferee) shall attach to its Illinois income tax return a copy of the certificate showing the names of the original donor and of the transferee, as provided in 47 Ill. Adm. Code § 355.309.

CARRYOVER OF EXCESS CREDIT

Any excess credit can be carried forward and applied to the tax liability of the five taxable years following the excess credit year.

- The tax credit is applied to the earliest year for which there is a tax liability, and the oldest carry-forward is to be used first.
- If a transferee elects to apply the credit in the tax year of the transfer, the carryforward period is limited to 5 years after the tax year of the donation.

XXII. TRANSPORTATION EMPLOYEE CREDIT

IITA § 215

Note: Repealed by PA 93-1033, effective July 1, 2004.

Each qualified employer (trucking company) is entitled to a credit of $50 per person for each eligible employee employed by the taxpayer as of the last day of the taxable year. Note that, because of the effective dates of the enactment and repeal, this credit can only be earned in a short taxable year that begins on or after January 1, 2004 and ends prior to July 1, 2004.

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A. QUALIFIED EMPLOYER

The term "qualified employer" means: (1) any employer who pays a commercial distribution fee under §3-815.1 of the Illinois Vehicle Code, or (2) any employer who has one or more employees whose compensation is subject to tax only by the employee's state of residence under 49 U.S.C. §14503(a)(1).

B. ELIGIBLE EMPLOYEE

An "employee" includes an individual who is treated as an employee of the taxpayer under Section 401(c) of the Internal Revenue Code and whose actual assigned duties are such that, if the individual were a common-law employee performing such duties in 2 or more states, the individual's compensation would be subject to tax only by the individual's state of residence. All the following additional criteria must be met by the employee to be an "eligible employee" for purposes of the credit:

- The employee must be an operator of a motor vehicle,
- The employee's compensation, pursuant to 49 USC 14503(a)(1), must be subject to tax only by the employee's state of residence, or would be subject to tax only by the employee's state of residence if the employee's actual duties were performed in 2 or more states,
- As of the end of the taxable year for which the credit is claimed, the employee must be a resident of Illinois, and
- The employee must be a full-time employee working 30 or more hours per week for 180 consecutive days; provided that such 180-day period may be completed after the end of the taxable year for which the credit is claimed

If the taxpayer is a partnership or Subchapter S corporation, the credit can flow through to the partners or shareholders in accordance with their distributive share of income.

XXIII. TAX CREDIT FOR HIRING EX-FELONS

IITA § 216

For tax years beginning on or after January 1, 2007, the Ex-Felons Jobs Credit is 5 percent (.05) of qualified wages paid during the taxable year to an employee who is a qualified ex-offender. The total credits for all tax years for wages paid to an ex-offender may not exceed $1500 ($600 for tax years ending prior to August 5, 2013 (the effective

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date of Public Act 98-165)). Note that the 2012 forms were not amended to implement the changes enacted in Public Act 98-165, which apply to fiscal filers for their tax years ending on or after August 5, 2013 and before December 31, 2013, who would use the 2012 forms.

A. Qualified Wages

- Includes only wages that are subject to federal unemployment tax under IRC § 3306, without regard to dollar limitation.

- Does not include any amounts paid or incurred by an employer for any period to any qualified ex-offender for whom the employer receives federally funded payments for on-the-job training for that period.

- Includes only wages attributable to service rendered.

- For partners, shareholders of Subchapter S corporations, and owners of limited liability companies, if the liability company are treated as a partnership for purposes of federal and state income taxation, the credit is allowed in accordance with the distributive share of income under IRC § 702, 704, and Subchapter S.

B. Qualified ex-offender

1. Requirements for this credit, “qualified ex-offender” means any person who:

- for tax years ending prior to August 5, 2013, an eligible offender; as defined under section 5-5.5-5 of the Unified Code of Corrections, which provides that an eligible offender means a person who has been convicted of a crime in this State or of an offense in any other jurisdiction that does not include any offense or attempted offense that would subject a person to registration under the Sex Offender Registration Act, the Arsonist Registration Act, or the Murderer and Violent Offender Against Youth Registration Act. "Eligible offender" does not include a person who has been convicted of committing or attempting to commit a Class X felony, aggravated driving under the influence of alcohol, other drug or drugs, or intoxicating compound or compounds, or any combination thereof, aggravated domestic battery, or a forcible felony. **“**Forcible felony" means first-degree murder, second-degree murder, aggravated arson, arson, aggravated kidnapping, kidnapping, aggravated

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battery that resulted in great bodily harm or permanent disability, and any other felony which involved the use of physical force or violence against any individual that resulted in great bodily harm or permanent disability.

- For tax years ending on or after August 5, 2013, an eligible offender is a person who has been convicted of a crime in this State or of an offense in any other jurisdiction, not including any offense or attempted offense that would subject a person to registration under the Sex Offender Registration Act.
    - Was sentenced to a period of incarceration in an Illinois adult correctional center; and
    - Hired; within one year (three years for tax years ending prior to August 5, 2013) after being released form an Illinois adult correctional center.

C. CARRYOVER OF EXCESS CREDIT

If the amount of the credit exceeds the tax liability for the year, the excess may be carried forward and applied to the tax liability of the five taxable years following the excess credit year. The tax credit shall be applied to the earliest year for which there is a tax liability. If there are credits for more than one year that are available to offset a liability, the earlier credit shall be applied first. Note: In no event shall this credit reduce the taxpayer's liability to less than zero.

XXIV. TAX CREDIT FOR HIRING VETERANS

IITA § 217

For tax years beginning on or after January 1, 2010 through December 31, 2016, each taxpayer is entitled to a credit in an amount equal to 10%, but in no event to exceed $1200, of the grows wages paid by the taxpayer to a qualified Veteran during sustained employment during the taxable year.

For tax years beginning on or after January 1, 2007, and ending on or before December 30, 2010, each taxpayer is entitled to a credit in an amount equal to 5%, but in no event to exceed $600, of the gross wages paid by the taxpayer to a qualified Veteran during employment during the taxable year.

For partners, shareholders of Subchapter S corporations the credit flows through in accordance with the determination of income and distributive share of income under IRC Sections 702 and 704 and Subchapter S.

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This credit is not exempted from automatic sunset under IITA § 250 and will not be allowed for taxable years beginning on or after January 1, 2015, the fifth anniversary of Public Act 96-101.

Note that both the new provisions enacted by Public Act 96-101 and the old provisions literally apply for tax years beginning on or after January 1, 2010 and ending before December 31, 2010. The 2009 forms that would be used by these taxpayers provide that the new provisions apply in these cases.

A. Qualified Veteran

"Qualified veteran" means an Illinois resident who:

- Was a member of the Armed Forces of the United States, a member of the Illinois National Guard, or a member of any reserve component of the Armed Forces of the United States;
- Served on active duty in connection with Operation Desert Storm, Operation Enduring Freedom, or Operation Iraqi Freedom;
- Has provided, to the taxpayer documentation showing that he or she was honorably discharged
- Initially hired, on or after January 1, 2007

For partners, shareholders of Subchapter S corporations, and owners of limited liability companies that are treated as partnerships, if the liability company are treated as a partnership for purposes of federal and state income taxation, the credit is allowed in accordance with the distributive share of income provisions in IRC § 702, 704, and Subchapter S.

B. SUSTAINED EMPLOYEMENT

Defined as "a period of employment that is not less than 185 days during the year"

C. CARRYOVER OF EXCESS CREDIT

If the amount of the credit exceeds the tax liability for the year, the excess may be carried forward and applied to the tax liability of the five taxable years following the excess credit year. The tax credit shall be applied to the earliest year for which there is a tax liability. If there are credits for more than one year

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that are available to offset a liability, the earlier credit shall be applied first. In no event shall this credit reduce the taxpayer's liability to less than zero.
Note: This credit cannot be used if IITA § 217.1 "Tax credit for hiring unemployed veterans" is used.

XXV. TAX CREDIT FOR HIRING UNEMPLOYED VETERANS

IITA § 217.1

For years ending on or after December 31, 2012 and on or before December 31, 2016, each taxpayer is entitled to a credit in an amount equal to 20%, but in no event to exceed $5,000, of the gross wages paid by the taxpayer to a qualified Veteran during sustained employment during the taxable year ending on or after the date of hire by the taxpayer. If the veteran was unemployed for an aggregate period of 4 weeks or more during the 6-week period ending on the Saturday immediately preceding the date, he or she was hired by the taxpayer.

For partners and shareholders of Subchapter S corporations the credit flows through in accordance with the determination of income and distributive share of income under IRC Sections 702 and 704 and Subchapter S.

A. Qualified Veteran

"Qualified veteran" means an Illinois resident who:

- Was a member of the Armed Forces of the United States, a member of the Illinois Nation al Guard, or a member of any reserve component of the Armed Forces of the United States.
- Served on active duty on or after September 11, 2001
- Provided to the taxpayer documentation showing that he or she was honorably discharged
- Was initially hired by the taxpayer on or after June 1, 2012.

B. SUSTAINED EMPLOYMENT

"Sustained employment" means:

- A period of employment that is not less than 185 days following the date of hire

- In the case of a veteran who was unemployed for an aggregate period of 6 months or more during the one-year period ending on the date the veteran

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was hired by the taxpayer, a period of employment that is more than 30 days following the date of hire.

- The period of sustained employment may be completed after the end of the taxable year in which the veteran is hired.

C. UNEMPLOYED

A veteran is "unemployed" for a week if he or she:

- Received unemployment benefits, defined in § 202 of the Unemployment Insurance Act.
  - Including but not limited to federally funded unemployment benefits
- Has not been employed since being honorably discharged.

D. CARRYOVER OF EXCESS CREDIT

If the amount of the credit exceeds the tax liability for the year, the excess may be carried forward and applied to the tax liability of the five taxable years following the excess credit year. The tax credit shall be applied to the earliest year for which there is a tax liability. If there are credits for more than one year that are available to offset a liability, the earlier credit shall be applied first. In no event shall this credit reduce the taxpayer's liability to less than zero.

Note: This credit cannot be used if IITA § 217 "Tax credit for hiring veterans" is used.

XXVI. STUDENT-ASSISTANCE CONTRIBUTIONS CREDIT

IITA 218 IAC §100.2193

For taxable years ending on or after December 31, 2009 and before December 31, 2020, each taxpayer is allowed a credit against the taxes imposed under IITA § 201(a) and (b) in an amount equal to 25% of each matching contribution made by the taxpayer during the taxable year.

A. MATCHING CONTRIBUTION

Means the total amount paid by the taxpayer during the taxable year to an individual Illinois College Savings Pool account or Illinois Prepaid Tuition Trust

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Fund account for the benefit of a designated beneficiary to the extent the amount paid does not exceed the total contributions made by an employee of the taxpayer during the taxpayer's taxable year to the same account for the benefit of the same designated beneficiary.

B. LIMITATION

The maximum allowed by any contributing employee shall not exceed $500 per taxable year.

> **Example:** Taxpayer is a calendar year taxpayer. Employee A is an employee of Taxpayer for the entire 2009 calendar year. During 2009, Employee A makes contributions totaling $6,000 each to three separate College Savings Pool accounts established for the benefit of each of Employee A's three children. During 2009, Taxpayer makes payments totaling $2,000 each to the same three accounts. Under subsection (a) of this Section, Taxpayer would be allowed a $500 credit for each of the three $2,000 matching contributions made during the taxable year, for a total credit of $1,500. However, under this subsection (c), Taxpayer may claim a maximum credit of only $500 in respect of the total of its contributions that match contributions made by Employee A. Therefore, the allowable credit is reduced from $1,500 to $500.

C. DOCUMENTATION REQUIREMENTS

Taxpayer claiming the credit allowed must maintain records enough to document the date and amount of each payment made to an individual College Savings Pool account or Illinois Prepaid Tuition Trust Fund account, as well as documentation regarding the contribution the payment matches. Documentation regarding the contribution the payment matches must include:

- employee's name,
- account, and
- amount and date of the employee's contribution.

D. PASS-THROUGH OF CREDIT

In the case of a partnership or subchapter S corporation, the credit passes through to the owners as provided in the partnership agreement under IRC § 704(a) or in proportion to their ownership of the stock of the subchapter S corporation under IRC § 1366(a).

- The credit earned by a partnership or subchapter S corporation shall be treated as earned by its owners as of the last day of the taxable year of

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partnership or subchapter S corporation in which the matching contribution is made.

E. CARRYOVER OF EXCESS CREDIT

If the amount of the credit exceeds the tax liability for the year, the excess may be carried forward and applied to the tax liability of the five taxable years following the excess credit year. The tax credit shall be applied to the earliest year for which there is a tax liability. If there are credits for more than one year that are available to offset a liability, the earlier credit shall be applied first. In no event shall a credit under this Section reduce the taxpayer's liability to less than zero.

XXVII. CREDIT FOR HISTORIC PRESERVATION EXPENDITURES

IITA § 219

Beginning with tax years ending on or after January 1, 2010 to on or before January 1, 2022, a taxpayer who qualifies for a credit under the Historic Preservation Tax Credit Pilot Program Act is entitled to a credit against taxes imposed.

HISTORIC PRESERVATION TAX CREDIT PILOT PROGRAM ACT (35 ILCS 30)

Allows a credit in the amount equal to 25% of qualified expenditures incurred on a hotel in Peoria, Illinois for restoration and preservation purposes pursuant to a qualified rehabilitation plan, provided the total amount of such expenditures must:

- Equal $5,000 or more
- Must exceed 50% of the purchase price of the property

The credit can the taxpayer earning the credit in the tax year in which qualified expenditures are made. The credit may be transferred, and the transferee may claim the taxable year of the transferee in which the property was placed in service or in the taxable year of the transferee in which the transfer occurred.

For partners and shareholders of Subchapter S corporations the credit flows through in accordance with the determination of income and distributive share of income under IRC Sections 702 and 704 and Subchapter S.

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CARRYOVER OF EXCESS CREDIT

The person earning the credit may carry any excess credit forward for ten years following the year for which the credit first earned until it is used. A transferee may carry any excess credit back for three years or forward for ten years.
Note: An application must be made to the Department no later than 6 months after the effective date of the Historic Preservation Tax Credit Pilot Program Act.

XXVIII. ANGEL INVESTMENT CREDIT

IITA § 220 IAC § 100.2171

For tax years beginning on or after January 1, 2011, and ending on or before December 31, 2021, this credit can taxpayers who make an investment in an innovative, qualified new business venture in Illinois. The credit is equal to 25% of investment (up to a maximum investment of $2 million); made directly into a qualified new business venture. To qualify for the credit, the taxpayer must have applied for and received a tax credit certificate from DCEO.

Note: After December 31, 2016 the taxpayer can still claim any distributive share of this credit passed through to Schedule K-1-P by reporting it on Schedule 1299-D, Line 41.

For partners and shareholders of Subchapter S corporations the credit flows through in accordance with the determination of income and distributive share of income under IRC Sections 702 and 704 and Subchapter S.

A. Eligible Qualified New Business Ventures

- Principally engaged in innovation
- Fewer than 100 employees at the time of original program certification
- Not been in operation in Illinois for more than 10 consecutive years prior to original program certification
- Headquarters located in Illinois
- At least 51% of employees are employed in Illinois
- Has the potential for increasing jobs or capital investments in Illinois, or both.

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- Has not received more than $10,000,000 in aggregate private equity investment in cash or $4,000,000 in investments that qualified for tax credits under this section
- Must be in good standing with the Illinois Department of Revenue

B. CARRYOVER OF EXCESS CREDIT

If the amount of the credit exceeds the tax liability for the year, excess carried forward and applied to the tax liability of the five taxable years following the excess credit year.

C. RECAPTURE OF CREDIT

The credit must be recaptured if:

- The taxpayer holds its qualifying investment for less than 3 years; or
- The qualified new business venture is moved outside Illinois less than 3 years after the investment is made.

XXIX. RIVER EDGE HISTORIC PRESERVATION CREDIT

IITA § 221

For tax years beginning on or after January 1, 2012 and ending prior to January 1, 2022 credit equal to 25% of the projects qualified expenditures to owners of certified historic structures located within River Edge Redevelopment Zones who undertake certified rehabilitations during the taxable year.

This credit is awarded by the DCEO; you must have applied for and received a tax credit certificate from them before using.

Projects must meet the following requirements.

1. The structure must be located within a River Edge Redevelopment Zone.

2. The structure requires certification as historic, which mean that it must meet one of these three criteria:

a. listed individually on the National Register of Historic places, or

b. a contributing building within a National Register of Historic Places, or

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c. a contributing building with a local historic district certified by the National Park Service for the purposes of taking the federal tax credit.

3. Qualified expenditures must equal or exceed $5,000 and must exceed 50% of the purchase price of the property when it last sold.

4. The structure must be used for income-producing purposes, such as rental-residential, commercial, agricultural, and/or industrial.

5. The qualified taxpayer/historic-structure owner must be in good standing with the Illinois Department of Revenue.

For partners and shareholders of Subchapter S corporations the credit flows through in accordance with the determination of income and distributive share of income under IRC Sections 702 and 704 and Subchapter S.

There is no exemption from Section 250; so, this credit will not be allowed in taxable years beginning on or after July 28, 2016, 5 years after the effective date of Public Act 97-0203.

CARRYOVER OF EXCESS CREDIT

If the amount of the credit exceeds the taxpayer's liability for the year, the excess may be carried forward and applied to the tax liability of the five taxable years following the excess credit year. The tax credit shall be applied to the earliest year for which there is a tax liability. If there are credits for more than one year that are available to offset a liability, the earliest credit applied first.

XXX. LIVE THEATER PRODUCTION CREDIT

IITA § 222 & 35 ILCS 17 Act

For tax years beginning on or after January 1, 2012 and before January 1, 2022, a taxpayer who has received a tax credit award under the Live Theater Production Tax Credit Act is entitled to a credit determined under the Act and determined by DCEO.

To qualify for the credit, taxpayers must apply with the Department of Commerce and Economic Opportunity, providing information necessary to calculate the credit.

- DCEO then issues the taxpayer a certificate that indicates the amount of eligible tax credit.

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- If the taxpayer is a partner in a partnership or Subchapter S corporation, the credit can flow through to the partners or shareholders in accordance with their distributive share of income.

Credit is transferable by the person earning the credit within one year after the credit is awarded. The transfers are made through DCEO, which will issue a certificate to the transferee stating the amount transferred and, if the transferor retains some of the credit, a certificate stating the amount retained.

CARRYOVER OF EXCESS CREDIT

If the amount of the credit exceeds the tax liability for the year, the excess may be carried forward and applied to the tax liability of the five taxable years following the excess credit year.

XXXI. HOSPITAL CREDIT

IITA § 223

For tax years ending on or after December 31, 2012 and ending on or before December 31, 2022, a taxpayer that is the owner of a hospital licensed under the Hospital Licensing Act (Ref. 210 ILCS 85/), not including an organization that is exempt from federal income taxes under the IRC, is entitled to a credit in an amount equal to the Illinois real property taxes paid during the tax year on real property used for hospital purposes during the prior tax year or the cost of free or discounted services provided during the tax year pursuant to the hospital's charitable financial assistance policy.

For partners, shareholders of Subchapter S corporations, and owners of limited liability companies, if the liability company are treated as a partnership for purposes of federal and state income taxation, there shall be allowed a credit in accordance with IRC § 702, 704, and Subchapter S.

A transfer of this credit may be made by the taxpayer earning the credit within one year after the credit earned in accordance with rules adopted by the Department.

CARRYOVER OF EXCESS CREDIT

If the amount of the credit exceeds the tax liability for the year, the excess may be carried forward and applied to the tax liability of the five taxable years following the excess credit year. The tax credit shall be applied to the earliest year for which there is a tax liability. If there are credits for more than one year that are available to offset a liability, the earlier credit shall be applied first. In no event shall this credit reduce the taxpayer's liability to less than zero.

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XXXII. INVEST IN KIDS CREDIT

IITA § 224; IAC § 100.2175

For taxable years beginning on and after January 1, 2018, and ending before January 1, 2023, a taxpayer may claim a credit against the income tax imposed under IITA § 201(a) and (b) in an amount equal to 75% of the qualified contribution amount awarded under the Invest in Kids Act that is shown on the Certificate of Receipt issued by an approved scholarship granting organization under 86 Ill. Adm. Code 1000.500. The credit may not be applied against the personal property replacement tax imposed under IITA Section 201(c) and (d).

A. CARRYOVER OF EXCESS CREDIT

The credit may be taken in the taxable year that includes the date of the Certificate of Receipt issued by an approved scholarship granting organization under 86 Ill. Adm. Code 1000.500.

- The credit may not be transferred.
- The credit may not be carried back and may not reduce the taxpayer's liability to less than zero.
- If the amount of the credit exceeds the tax liability for the year, the excess may be carried forward and applied to the tax liability of the 5 taxable years following the excess credit year. The credit shall be applied to the earliest year for which there is a tax liability. If there are credits from more than one tax year that are available to offset a liability, the earlier credit shall be applied first. (IITA Section 224(c))

B. PARTNERSHIP OR SUBCHAPTER S CORP

In the case of a credit earned by a partnership or subchapter S corporation, the credit passes through to the owners as provided in the partnership agreement under IRC section 704(a) or in proportion to their ownership of the stock of the subchapter S corporation under IRC section 1366(a). The credit earned by a partnership or subchapter S corporation will be treated as earned by its owners as of the last day of the taxable year of the partnership or subchapter S corporation in which the Certificate of Receipt is issued by an approved scholarship granting organization under 86 Ill. Adm. Code 1000.500, and shall be allowed to each owner in the taxable year of the owner in which the taxable year of the partnership or subchapter S corporation ends.

Tax credits are capped at $1 million per taxpayer per year; a donor can contribute about $1.33 million to receive the maximum tax credit allowed. A credit awarded under the Invest in Kids Act may not be claimed for any qualified contribution for which the taxpayer claims a federal income tax deduction. (IITA Section 224(d))

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A taxpayer shall retain and provide at the request of the Department the Certificate of Receipt issued by an approved scholarship granting organization and, in the case of a partner in a partnership or shareholder of a subchapter S corporation that earned the credit, a Schedule K-1-P or other written statement from the partnership or subchapter S corporation stating the portion of the total credit shown on the Certificate of Receipt that is allowed to that partner or shareholder and the taxable year of the partnership or subchapter S corporation in which the Certificate of Receipt was issued.

C. EXAMPLES

- EXAMPLE 1: Individual A contributes $5,000 to an approved scholarship granting organization on January 25, 2018. Individual A receives a Certificate of Receipt in the amount of $5,000. On April 1, 2019, Individual A files a 2018 U.S. Form 1040 with Schedule A Itemized Deductions. Individual A does not include any part of the $5,000 contribution under Gifts to Charity on Schedule A. Individual A is entitled to claim an Invest in Kids tax credit in the amount of $3,750 on Individual A's 2018 Form IL-1040, Schedule 1299-C. Deductions.
- EXAMPLE 2: Individual B contributes $5,000 to an approved scholarship granting organization on January 25, 2018. Individual B receives a Certificate of Receipt in the amount of $5,000. On April 1, 2019, Individual B files a 2018 U.S. Form 1040 with Schedule A Itemized Deductions. Individual B includes $1,250 (25% of the qualified contribution) under Gifts to Charity on Schedule A. Individual B is not entitled to claim any Invest in Kids tax credit on Individual B's 2018 Form IL-1040, Schedule 1299-C.

- EXAMPLE 3: Corporation C contributes $1 million to an approved scholarship granting organization on January 5, 2018. Corporation C receives a Certificate of Receipt in the amount of $1 million. On October 15, 2019, Corporation C files a 2018 U.S. Form 1120 and excludes the $1 million from the charitable contributions line of the return. Corporation C is entitled to claim an Invest in Kids tax credit in the amount of $750,000 on Corporation C's 2018 Form IL-1120, Schedule 1299-D.

- EXAMPLE 4: Corporation D contributes $5 million to an approved scholarship granting organization on January 5, 2018. Corporation D receives a Certificate of Receipt in the amount of $1,333,333.Tax credits are capped at $1 million per taxpayer per year; a donor can contribute about $1.33 million to receive the maximum tax credit allowed$1.33 million x .75% = $997,500). On October 15, 2019, Corporation D files a 2018 U.S. Form 1120 and includes $3,666,667 ($5 million less the maximum qualified contribution) on the charitable contributions line of the return. Corporation D is entitled to claim an Invest in Kids tax credit in

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the amount of $1 million on Corporation D's 2018 Form IL-1120, Schedule 1299-D.

XXXIII. CREDIT FOR INSTRUCTIONAL MATERIALS AND SUPPLIES

IITA § 225

For taxable years beginning on and after January 1, 2017, a taxpayer shall be allowed a credit in the amount paid by the taxpayer during the taxable year for instructional materials and supplies with respect to classroom based instruction in a qualified school, or $250, whichever is less, provided that the taxpayer is a teacher, instructor, counselor, principal, or aide in a qualified school for at least 900 hours during a school year.

A. CARRYOVER OF EXCESS CREDIT

The credit may not be carried back and may not reduce the taxpayer's liability to less than zero. If the amount of the credit exceeds the tax liability for the year, the excess may be carried forward and applied to the tax liability of the 5 taxable years following the excess credit year. The tax credit shall be applied to the earliest year for which there is a tax liability. If there are credits for more than one year that are available to offset a liability, the earlier credit shall be applied first.

B. DEFINITION

- "materials and supplies" mean amounts paid for instructional materials or supplies that are designated for classroom use in any qualified school.
- "qualified school" means a public school or non-public school located in Illinois.

Note: This Section is exempt from the provisions of IITA § 250

XXXIV. NATURAL DISASTER CREDIT

IITA § 226

For taxable years than begin on or after January 1, 2017 and begin prior to January 1, 2019, each taxpayer who owns qualified real property located in a county in Illinois that was declared a State disaster area by the Governor.

What is considered qualified real property for credit:

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- Is located in a county in Illinois that was declared a state disaster area due to flooding in 2017 or 2018,
- Was damaged as a result of events related to this flooding, and
- Did not and will not receive a Natural Disaster Homestead Exemption on property taxes as a result of this flooding for 2017 or 2018.

DEFINITIONS

- "Qualified real property" means real property that is: (i) the taxpayer's principal residence or owned by a small business; (ii) damaged during the taxable year because of a disaster; and (iii) not used in a rental or leasing business.

- "Small business" has the meaning given to that term in Section 1-75 of the Illinois Administrative Procedure Act.

Deduction

The lesser of $750 or the deduction allowed under IRC § 165(h) Treatment of Casualty Gains and Losses.

Documentation

- The township assessor or, if the township assessor is unable, the chief county assessment officer of the county in which the property is located, shall issue a certificate to the taxpayer identifying the taxpayer's property as damaged because of the natural disaster.
- The certificate shall include the name and address of the property owner, as well as the property index number or permanent index number (PIN) of the damaged property. The taxpayer shall attach a copy of such certificate to the taxpayer's return for the taxable year for which the credit is allowed.

A. CARRYOVER OF EXCESS CREDIT

In no event shall a credit under this Section reduce a taxpayer's liability to less than zero. If the amount of credit exceeds the tax liability for the year, the excess may be carried forward and applied to the tax liability for the 5 taxable years following the excess credit year. The tax credit shall be applied to the earliest year for which there is a tax liability. If there are credits for more than one year that are available to offset liability, the earlier credit shall be applied first.

B. PARTNERSHIP AND SUBCHAPTER S CORP

If the taxpayer is a partnership or Subchapter S corporation, the credit shall be allowed to the partners or shareholders in accordance with the determination of

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income and distributive share of income under IRC § 702, 704 and Subchapter S.

C. CREDIT DENIAL

A taxpayer is not entitled to the credit under this Section if the taxpayer receives a Natural Disaster Homestead Exemption under Section 15-173 of the Property Tax Code with respect to the qualified real property because of the natural disaster.

The township assessor or, if the township assessor is unable to certify, the chief county assessment officer of the county in which the property is located, shall certify to the Department a listing of the properties located within the county that have been damaged as a result of the natural disaster (including the name and address of the property owner and the property index number or permanent index number (PIN) of each damage property).

XXXV. ADOPTION CREDIT

IITA § 227

For tax years beginning with tax years ending on or after December 31, 2018, a taxpayer who received the federal adoption tax credit (IRC § 23) may claim an Adoption Credit. The maximum amount of qualified adoption expenses for all taxable years with respect to the adoption of a qualifying dependent child by the taxpayer shall not exceed:

- $2,000 ($1,000 married filing separate) per eligible child, or
- $5,000 ($2,500 married filing separate) per eligible child who is at least one year of age and a resident of Illinois at the time of adoption, or
- The federal adoption tax credit if less than $2,000 or $5,000 as defined above.

Taxpayer can claim the credit when the qualified expenses were paid or incurred:

- **Before** the taxable year in which the adoption becomes final, they you may claim this amount in the taxable year following the taxable year during which the expenses were paid or incurred.
    - **Example:** taxpayer incurred expenses in 2018; however, the adoption is not final, you may claim the expenses on the 2019 tax return
- **During or after:** the taxable year in which such adoption becomes final, then you may claim this amount in the taxable year in which the expenses were paid or incurred.
    - **Example:** the adoption was final in 2018; however, taxpayer has expenses in 2019, the taxpayer may claim the expenses in the 2019 taxable year.

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Definitions

Eligible Child – any individual who has not attained age 18 or is physically or mentally incapapble of caring for himself or herself.

Qualified Expenses – as defined by IRC § 23(d), are any reasonable and necessary adoption fees, court costs, attorney fees, and other expenses which are:

- Directly related to, and the principal purpose of which is, the leagal adoption of an eligible child by the taxpayer,
- Not incurred in violation of State or Federal law or in carrying out any surrogate parenting arrangement,
- Not expenses in connection with the adoption by an individual of a child who is the child of such individual's spouse, and
- Not reimbursed under an employer program or otherwise.

These expenses are generally listed on Line 5 of the federal Form 8839, Qualified Adoption Expenses.

Additional Information

- No credit shall be allowed for any expense that received Federal, State or local funds.
- Spouses filing a joint return are considered one taxpayer.
- For nonresident and part-year residents, the amount of credit is proportionate to the amount of income attributable to Illinois.

A. CARRYOVER OF EXCESS CREDIT

The credit should not reduce a taxpayer's liability to less than zero. If the credit exceeds the income tax liability for the applicable tax year, the excess may be carried forward for five taxable years. The credit should be applied to the earliest year for which there is a tax liability.

XXXVI. FOREIGN TAX CREDIT

IITA § 601(b)(3); IAC § 100.2197

Excerpt shown below:

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 the tax imposed by subsections 201(a) and (b) of this Act shall be

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credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year.

The above excerpt simply states:

If you're an Illinois taxpayer who works in Illinois or in another state and the other state taxes income, Illinois will provide a credit against the taxes paid in the other state. Also, nonresident working in Illinois will be taxed based on Illinois tax law instead of the nonresident state's law to determine the credit amount.

For taxable years ending on or after December 31, 2009, the credit provided under this paragraph for tax paid to other states shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) otherwise due under this Act as the amount of the taxpayer's base income that would be allocated or apportioned to other states if all other states had adopted the provisions in Article 3 of this Act bears to the taxpayer's total base income subject to tax by this State for the taxable year.

For taxable years ending prior to December 31, 2009, the aggregate credit provided under this paragraph shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) otherwise due under this Act as the amount of the taxpayer's base income subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this State for the taxable year.

The credit provided by this paragraph shall not be allowed if any creditable tax was deducted in determining base income for the taxable year.

Any person claiming such credit 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 hereunder all in such manner and when the Department shall by regulations prescribe.

XXXVII. NEW MARKETS CREDIT

20 ILCS 663/5

A person or entity that makes a qualified equity investment "QEI" as defined under 20 ILCS 663/5 earns a vested right to tax credits as follows:

- "Tax credit" means a credit against any income, franchise, or insurance premium taxes due under Illinois law.

- on each credit allowance date of the qualified equity investment, the purchaser of the qualified equity investment, or subsequent holder of the QEI, is entitled to a tax credit during the taxable year including that credit allowance date;

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- The tax credit amount shall be equal to the applicable percentage of the purchase price paid to the issuer of the QEI:
  - 0% for each of the first 2 credit allowance dates
  - 7% for the third credit allowance date
  - 8% for the next four credit allowance dates

- the tax credit amount shall be equal to the applicable percentage for such credit allowance date multiplied by the purchase price paid to the issuer of the qualified equity investment; and

- the amount of the tax credit claimed shall not exceed the amount of the State tax liability of the taxpayer for the tax year for which the tax credit is claimed.

A company doing insurance business in this State claiming a tax credit against insurance premium taxes payable pursuant to Section 409 of the Illinois Insurance Code is not required to pay any additional retaliatory tax imposed pursuant to Section 444 or 444.1 of the Illinois Insurance Code related to that claim for a tax credit. REF: P.A. 95-1024, 20 ILCS 663/10.

Tax credits earned by a partnership, limited liability company, S corporation, or other "pass-through" entity may be allocated to the partners, members, or shareholders of that entity for their direct use in accordance with the provision of any agreement among the partners, members, or shareholders

The Illinois Department of Revenue has the right to recapture under the following provisions:

- Any amount of the federal tax credit available with respect to a qualified equity investment that is eligible under this program is recaptured under the federal NMTC program.

- The issuer redeems or makes principal repayment with respect to a qualified equity investment prior to the seventh anniversary of the issuance of such qualified equity investment.

- The issuer fails to invest at least 85 percent of the cash purchase price of the QEI in QLICI in the State of Illinois within 12 months of the issuance of the QEI and maintain such a level of investment in QLICI in Illinois until the last credit allowance date for such QEI.

XXXVIII. SMALL BUSINESS JOB CREATION TAX CREDIT

35 ILCS 25/Act

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The Illinois Small Business Job Creation Tax Credit is available for eligible businesses through tax years ending before June 30, 2016. Eligible businesses are entitled to a credit against withholding taxes in connection with the hiring of new full-time employees, so long as that hiring results in a net increase in full-time employees and that the increase is maintained for at least 12 months. This credit must be claimed in the first year ending on or after the day DCEO issues a tax credit certificate to the taxpayer.

To qualify for the credit, a new job must be sustained for at least one year and pay at least $18,200 annually (basic wage of $10.00 per hour for 35 hours per week).

CREDIT AMOUNT

For small businesses with less than 50 employees, the credit is $2,500 per job on withholding tax for employers who hire new, full-time Illinois employees during the 12-month period beginning July 1, 2010. Businesses hiring "Put Illinois to Work" worker-trainee are entitled to one-half of the credit, $1,250, allowable if that employee is employed for at least 6 months after the date of hire. The employer is entitled to the other half of the credit, $1,250, if that employee is employed for at least 12 months after the date of hire. (35 ILCS 25/25(d); 14 Ill. Adm. Code § 529.80) The program will be capped once a total of $50,000,000 in credits have been awarded. (35 ILCS 25/30)

XXXIX. UNITARY GROUPS FILING COMBINED ILLINOIS RETURNS

IAC § 100.5270(d) deals with the applicability and computation of credits for taxpayers that are members of a unitary business group filing a combined Illinois return. The designated agent will compute any credit allowed by the IITA based on the combined activities of the members of the combined group and such credit will be applied against the combined liability of the combined group. REF: IAC § 100.5270(d)(1).

The Replacement Tax Investment Credit, Enterprise Zone Investment Credit, High Impact Business Investment Credit and the Coal Research and Utilization Equipment Credit are all based on certain property purchased and placed in service by the taxpayer. The combined return members will be allowed the credits, assuming all other requirements of the credits are met, if one member purchases the property and another uses the property. In addition, the second part of the Replacement Tax Investment Credit and the Jobs Tax Credit, which involve specified increases in employment, will be determined to be applicable based on the group's combined employment increase and not each individual member's increase.

A. CARRYOVER OF EXCESS CREDITS

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Any combined return credit carry-forward is available to the combined group for the next combined return year. If one member becomes ineligible to be included in the subsequent combined returns, the carry-forward continues to be available to the remaining members IF the remaining members continue to both own and use the property for which the credit was claimed in a qualified manner for 48 months after the placed-in-service date.

If the member that has become ineligible is the entity owning and using the property involved, then the carry-forward is available to that member if, again, the member continues to own and use the property in a qualified manner for 48 months after the placed-in-service date. The amount of carry-forward available to the now-ineligible member is computed as the combined unused credit multiplied by a fraction, the numerator of which is the total amount of the original combined credit attributable to the now-ineligible member and the denominator of which is the total original combined credit for the group.

- Refer to IRC § 100.5270(d)(4), which contains several examples.

B. RECAPTURE OF CREDIT

When the property ceases to be qualified property or is moved out of the state (or Enterprise Zone) within 48 months of the placed-in-service date, the members of the combined return are responsible for the recapture of any Income or Replacement Tax originally offset by the credit. The member (or group) who owns and uses the property when it becomes disqualified is responsible for the recapture.

Refer to IAC § 100.5270(d)(5), which contains several examples.

XL. ENTERPRISE ZONES

Enterprise Zones are economically distressed areas in Illinois, of up to ten square miles, which qualify for special tax incentives once they are designated by the state and participating local governments. An FY bulletin has been issued by the Department for each Enterprise Zone identifying, in addition to other information, its date of designation.

Section 5.3 of the Illinois Enterprise Zone Act provides that the zones will be in effect for a period of 20 years from the date of certification unless a lesser number of years are specified in the certified designating ordinance.

Boundaries within any specific Enterprise Zone are continually being amended. If there is any question whether an address is located within the boundaries of a zone, the

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administrator for that zone should be contacted. A complete list of enterprise zone administrators along with their phone numbers can be found under the web site for The Department of Commerce and Economic Opportunity (DCEO).

Refer to the DCEO website for up-to-date information.

XLI. FOREIGN TRADE ZONES

Foreign Trade Zones are secured areas legally outside a nation's customs territory. Their purpose is to attract and promote international trade or commerce.

> Requests for additional information regarding the Foreign Trade Zones should be directed to the contact person for the zone project. Refer to the DCEO website for up-to-date information.

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SECTION 404 ADJUSTMENTS

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I. PURPOSE

This chapter discusses the auditor's ability to make certain adjustments to a taxpayer's income or deductions to properly report Illinois base income where certain arrangements between taxpayers distort the allocable Illinois base income. The statutory authority to do so is found in IITA § 404. A proposed audit adjustment under this IITA section is often referred to as a "Section 404 adjustment" or simply a "404 adjustment".

This chapter provides a general background of Section 404 adjustments, the procedure to request such adjustment, and several alternative adjustments when a 404 adjustment is prohibited.

II. REFERENCES

The following is a general list of sources regarding Section 404 adjustments. Other and more specific references are made throughout the chapter. This list is by no means exhaustive.

- IITA § 404(a) & (b)
- IAC § 100.2430
- P.A. 93-0840, P.A. 95-0233, P.A. 95-0707, P.A. 95-0948, and P.A. 100-22
- IITA § 203(a)(2)(D-17), (b)(2)(E-12), (c)(2)(G-12) and (d)(2)(D-7)
- IITA § 203(a)(2)(D-18), (b)(2)(E-13), (c)(2)(G-13) and (d)(2)(D-8)
- IITA § 203(a)(2)(D-19), (b)(2)(E-14), (c)(2)(G-14) and (d)(2)(D-9)
- IITA § 203(a)(2)(CC), (b)(2)(V), (c)(2)(T) and (d)(2)(Q)
- IITA § 203(a)(2)(DD), (b)(2)(W), (c)(2)(U) and (d)(2)(R)
- IITA § 203(a)(2)(EE), (b)(2)(X), (c)(2)(V) and (d)(2)(S)
- IITA § 203(a)(2)(GG), (b)(2)(Y), (c)(2)(Y) and (d)(2)(T)
- IRC § 482
- 26 CFR § 1.482-1
- Illinois Schedule 80/20

III. GENERAL INFORMATION

Under IITA § 404, income and deductions can be reallocated and any factor taken into account in allocating income to the state if it appears to the Director that, as the result of any agreement, understanding or arrangement between the taxpayer and any other person, they were reported improperly or inaccurately so as not to reflect the correct tax liability.

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> Note: This should not be confused with IITA § 304(f) that pertains to the Department's authority to apply an alternative apportionment method where the statutory formula fails to reflect the business activity or the market for the taxpayer's goods or services. (REF: Audit Manual Chapter 27).

Under P.A. 95-0948, effective August 29, 2008, the Department cannot make any Section 404 adjustments to base income which would have the same effect as retroactively applying the add-back provisions which were added to the Illinois Income Tax Act by P.A. 93-0840, 95-0233 or 95-0707. The add-back provisions involve modifications for interest, royalties and other intangible expenses paid to an 80/20 company (added by P.A. 93-0840) or to a company which is excluded from the combined return due to the noncombination rule (added by P.A. 95-0233) and dividends paid by real estate investment trusts (added by P.A. 95-0233 and P.A. 95-0707).

Because of this legislative change, audits which involve possible Section 404 adjustments are to be reexamined to determine if the facts support an adjustment that does not rely on Section 404.

If a taxpayer argues that its situation is the same as the fact situation involved in a private letter ruling, confirm that their facts are identical to the facts stated in the ruling before any decision can be made. Point to the following language which is included in all private letter rulings:

> The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete.

Even the taxpayer who receives a ruling cannot rely upon it if their factual representations were incorrect. If a taxpayer does not provide the documents needed to allow confirmation, assume that the facts per audit are not identical with the facts contained in the letter ruling.

P.A. 100-22, effective July 6, 2017, repealed the noncombination rule and expanded the definition of "United States" to include the outer continental shelf (OCS) for taxable years ending on or after December 31, 2017. Domestic unitary affiliates that apportion under different subsections of IITA § 304 will be able to be included in the same Illinois UBG. This eliminates the related-party expense modifications for noncombination companies for the applicable tax periods. Due to intercompany eliminations, many transactions that required 404 adjustments between unitary domestic companies should not be necessary for the applicable periods.

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A. POTENTIAL AUDIT SITUATIONS TO REQUEST 404 ADJUSTMENT

Section 404 adjustments should not be proposed lightly, so remember the following four things:

- If any other statutory option exists to make the audit adjustment, pursue that option.
- There must be some type of arrangement between entities that improperly affects the base income allocated to Illinois, which can be documented and proven.
- 404 adjustments are not permitted for any adjustment that is covered by our 80/20 add-back provisions for any year. Also, with the elimination of the noncombination rule for taxable years ending on or after 12/31/17, this should reduce the need to pursue 404 adjustments between affiliated companies.
- While situations will arise where a Section 404 adjustment is warranted, these should be the exception, not the rule.

A 404 adjustment can be sought when the taxpayer has improperly shifted taxable income out of Illinois's reach through a transaction with an affiliate. Two principal ways this can be done is to create transactions, that either increase expenses paid by the taxable Illinois UBG or to reduce the income of the taxable Illinois UBG, with an affiliate not taxable by Illinois. Many of the common ways of using loans and intangible assets to reduce net income are dealt with by the 80/20 modifications. However, the area to consider that is not prohibited by P.A. 95-0948 and not remedied by 80/20 modifications is where the Illinois taxpayer is underreporting income.

An example of this would be a zero-interest loan to an affiliate that is not part of an Illinois UBG. In this scenario, the taxpayer would not be receiving the interest income that would normally be received from an arm's length transaction. Thus, Illinois base income is less than what would accurately be reported if the taxpayer provided the loans in an arm's length transaction. No other statutory remedy exists, as would be the case if the taxpayer had borrowed money from an affiliate and could be adjusted from an 80/20 addition modification. It would be possible to request that the Illinois taxpayer report imputed interest income through a Section 404 adjustment.

The following is a list of potential transactions where an Illinois taxpayer could underreport income allocable to Illinois from transactions not conducted at arm's length, and a 404 adjustment may be considered:

- Taxpayer makes a loan or advance to another entity and charges no interest or does not charge an arm's length interest rate,
- Taxpayer performs services for another entity without charge or at a charge which does not reflect an arm's length payment,
- Taxpayer leases property to another entity at a rental charge that is not an arm's length rental charge,

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- Taxpayer sells property to another entity at a sales price that is not an arm's length price.
- Taxpayer leases intangible property to another entity for no royalty fee or a fee that is not an arm's length fee.
- Taxpayer enters into a cost sharing arrangement with another entity to share costs to develop intangibles but all related costs are not shared.

In each transaction, the concern would be with the Illinois taxpayer and an affiliate that is not part of the Illinois UBG, due to the noncombination or 80/20 rules of IITA § 1501(a)(27). Intercompany eliminations or offsets would correct the imbalance if the affiliate were part of the Illinois UBG, but not when the affiliate is outside of Illinois's taxing authority. In each scenario, the Illinois UBG would underreport Illinois base income due to transactions that charge less than market rates. In these scenarios, it may be necessary to explore whether a 404 adjustment should be requested. For taxable years ending on or after December 31, 2017, the noncombination rule no longer applies. This means that some 404 adjustments between domestic affiliates will no longer need to be pursued, since the parties should be part of the same UBG and the transaction subject to intercompany elimination.

The taxpayer may attempt to argue that the transactions are conducted at arm's length. For example, if the taxpayer is attempting to argue that there is an arm's length transaction in a loan between the companies, then look to see if the companies are abiding by the terms specified in the loan agreement. For instance, are payments being made timely between the subsidiaries? Are penalties being charged for any late payments? Are fluctuations in the prime rate being adjusted in a timely manner? Obtain the recipient's bank account statements. Many interest or dividend payments are made by electronic fund transfer (EFT), and within hours or days an EFT sent back to the parent or domestic subsidiary, which does not qualify for the 80/20 test. If the taxpayer is not abiding by the terms of any contracts provided, then this would be a basis for claiming that the terms are not really arm's length.

IRC § 482 contains a provision for the IRS similar to IITA § 404. Federal regulations are in 26 CFR § 1.482-1 (Allocation of income and deductions among taxpayers). This federal regulation contains a lengthy discussion on arm's length transactions and the application of IRC § 482.

IV. PROCEDURES FOR REQUESTING A SECTION 404 ADJUSTMENT

A. DETERMINING VALIDITY OF 404 ADJUSTMENT

When encountering an audit situation where Section 404 might apply, collect the necessary documentation to support the adjustment.

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Gather whatever documents the taxpayer has within its possession to support an audit position and include a copy in the audit file. Follow the guidance outlined in Audit Manual Chapter 20 under "Information Document Requests (IDRs) and Documenting Taxpayer Meetings". If documentation cannot be obtained, then identify in the Auditor's Comments what documents the taxpayer has in its files (correct document names, dates, etc.) so that Legal can request them during discovery.

Documentation Needed (not all-inclusive):

- All written agreements setting up the questionable transaction(s) or tax plan, such as:
  - stock purchase agreements
  - credit agreements
  - licensing agreements, etc.
- All written agreements evidencing intercompany loans and payments
- Any other documents that trace the exchange of funds, such as
  - books and records
  - wire transfers
  - transaction slips
  - journal entries, etc.
- Board of directors meeting minutes and resolutions approving the arrangement in question
- Accounting firm proposal, if any, explaining the arrangement to reduce/shelter taxes (the accounting firm's pitch for the created tax plan)
- Any tax department interoffice recommendations or correspondence regarding the approval or ideas for the tax plan at issue
- Any documentation evidencing the transfer of assets and cash to an 80/20 company to set up the arrangement, such as:
  - transfer of intellectual property
  - loans, etc.
- A detailed balance sheet matching up expenses with income. For example:
  - the royalty expense paid to a wholly owned 80/20 company for use of intellectual property
  - income received by the 80/20 for licensing the intellectual property
- If very complicated, any diagrams that would help to understand the transactions in question
- Any IDRs issued to the taxpayer with taxpayer responses attached
- Any information that shows where the work is actually being performed (in the US or overseas)
- Documentation evidencing property overseas, such as any lease for the following:
  - office space
  - computer equipment
  - telephones, etc.

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- Employment contracts for overseas employees
  - Is the foreign "employee" a true employee, or an independent contractor?
  - Who else does this person work for, if any one?
- Identification of the board of directors for the parties at issue. Identification of all employees, if a few employees exist.
- Corporate structure flowchart, including minority interest
- Intercompany eliminations details to identify the flow of values to affiliated companies

B. PRESENT SECTION 404 REQUEST TO IMMEDIATE AUDIT SUPERVISOR

If the audit supervisor determines that there is potential for a Section 404 adjustment, then take the following steps:

1. Clearly summarize the facts and adjustment in a memorandum, including the estimated tax effect
2. Email the memorandum with all supporting documentation to the Audit Supervisor
3. The Audit Supervisor will forward the request to the Income Tax Technical Support Supervisor for review.

C. TECHNICAL SUPPORT REVIEW

If Technical Support agrees with the auditor's recommendation, it will be forwarded to the following management personnel who will confer and then decide whether a Section 404 adjustment is appropriate:

1. Technical Support Supervisor
2. Audit Division Manager
3. Audit Bureau Manager
4. Revenue Chief Counsel

D. 404 DECISION

If the above-mentioned Management determines that the 404 adjustment is appropriate, it will be presented to the Director for approval. If the Director approves the 404 adjustment, a Technical Response will be issued explaining the adjustment and communicating the approved adjustment.

If at any stage Technical Support, Management, or the Director do not approve, no Technical Response will be issued. An email will be sent to the auditor and auditor's

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supervisor to communicate the final decision if the Section 404 adjustment is approved or not. Technical Support will keep copies of the technical requests for future reference.

V. ALTERNATIVES TO PURSUING 404 ADJUSTMENTS

Many situations that involve the shifting of income and expenses between 80/20 companies and noncombination companies are addressed by the add-back modifications found in IAC § 100.2430. Because of P.A. 95-0948, effective August 29, 2008, the Department is prohibited from using Section 404 adjustments to retroactively apply those add-back modifications to periods before they were legally enacted:

- For 80/20 companies, taxable years ending prior to 12/31/04.
- For noncombination companies, taxable years ending prior to 12/31/08;
- For dividends paid by REITs, taxable years ending prior to 12/31/09.

If audits are being conducted on these older periods, while pursuing a Section 404 adjustment is prohibited, it may be possible to pursue alternative adjustments to correct the shifting of income or expenses. The discussion that follows addresses alternatives to consider for the following situations:

A. 80/20 Test, Financial Group
B. REIT, Financial Group
C. REIT, Three-factor Group
D. 80/20 Company Owning Capital or Intellectual Property
E. Noncombination Group, Captive Insurance

This analysis focuses on the possibility of disqualifying the 80/20, REIT, or insurance status of an entity. Remember, some of the transactions between noncombination companies will no longer need consideration for Section 404 with the repeal of the noncombination rule for taxable years ending on or after December 31, 2017.

<u>One-Factor Financial Organizations</u>

The Department has identified two main audit issues with respect to financial organizations that apportion their income under IITA § 304(c) that have subsidiaries in tax-haven countries:

1. A financial subsidiary that has minimal operations in a foreign country that receives interest income outside the U.S, and
2. A holding company in a foreign country that receives dividend income from a domestic real estate investment trust (REIT).

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The taxpayer will attempt to claim that the 80/20 test has been met under IAC § 100.9700(c)(2) because the interest or dividends were received outside the U.S. In both cases the 80/20 company will probably be in the consolidated federal return so that its income is taxed federally, but since the 80/20 is excluded from the unitary group, its interest or dividend income is shifted off of the Illinois return.

The Legislature attempted to close this loophole for tax years ending on or after December 31, 2008, by expanding the use of Schedule 80/20 to include interest, royalties and premium expenses paid to an affiliated company that would have been included in the same unitary group if it were not for the noncombination rule. See IAC § 100.2430 for more information. Also, for tax years ending on or after December 31, 2009, IITA § 203(b)(2)(E-15) creates an addition modification for the REIT dividend paid deduction.

A. 80/20 TEST – FINANCIAL ORGANIZATIONS

For taxpayers that apportion their income under IITA § 304(c), the 80/20 test is based on the apportionment factor for financial organizations in IAC § 100.3400. The numerator of the 80/20 test is the financial organization's receipts in the U.S. and the denominator is total receipts worldwide. The taxpayer's 80/20 test is going to show that the receipts were received in a foreign country with little or no receipts received in the U.S. If Audit can prove that the 80/20 is not receiving dividends, interest and/or royalties in a foreign country, then the 80/20 company will not qualify as a foreign company under IAC § 100.9700(c)(2).

1. STEPS TO DISPROVE THE 80/20 TEST FOR A FINANCIAL ORGANIZATION

Secure the following documents:

- Records that show how the 80/20 was initially capitalized along with the dollar amount of the initial capitalization and any subsequent transfers of capital (to see if the 80/20 subsidiary is adequately capitalized)
- Sample journal entries of the domestic company's transactions with the 80/20
- Any flowcharts that may be helpful in showing the 80/20's transactions and interdependence with domestic subsidiaries
- Sample copies of the 80/20's bank statements
- Sample copies of wire transfers of funds
- Sample copies of pages of the 80/20's general ledgers (samples that can be faxed or scanned from the foreign country)
- A list of officers and directors of the 80/20 and where their offices are located
- Identify other employees who provide services for the 80/20, both domestic and foreign, including data processing, tax preparation, or bank services

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- Copies of every written agreement between the parent and the 80/20 relating to services performed for the 80/20
- Copies of written agreements with third parties outside of the U.S. that provide services for the 80/20 (e.g., office space, storage space, acting as agent for service processing, etc.)
- Copies of any loan documents between the parent and the 80/20

Some of this information may already be in possession if persistent in obtaining documents requested on the EDA-132 Unitary Questionnaire. Any documents not in possession should be requested on an EDA-70. If the taxpayer refuses to furnish the information, then follow the Subpoenas Procedures in Chapter 20 of the Audit Manual. Every effort should be made to secure the documents on an EDA-70 before resorting to the issuance of EDA-11-A and subpoenas.

2. CHECK WIRE TRANSFERS WITH THE 80/20

If the 80/20 apportions its income under IITA § 304(c), then the 80/20 test is not based on property or payroll but on where the 80/20 receives its income. If the 80/20 is receiving income from a domestic affiliate, then there must be actual wire transfers of funds to a foreign bank account as opposed to just intercompany accounting entries. It is imperative to review fund transfers and bank statements of the 80/20 to assure that the funds were received by a foreign bank.

If the 80/20 is mostly inactive, then frequently the only thing that happens is that someone at the 80/20 company wires the money back to the parent the next day or even within a few hours. If that is the case, then the Department will not question the transaction if the taxpayer can show that they relied on one of the current public letter rulings that allow this as a foreign receipt. The taxpayer can demonstrate that they relied on the ruling by having a copy of the letter ruling in their books and records, email correspondence with their tax preparer dated to the time when the return was prepared, etc.

3. ARM'S LENGTH TRANSACTIONS

If the 80/20 made loans back to the parent or domestic subsidiaries, then verify that the transactions were at arm's length. Review the loan agreements to verify that the interest rates were similar to what a bank would charge, and if the interest rate was linked to the prime rate, then check to see if the interest rate on the loan fluctuated with the prime rate.

In addition, verify that the companies abided by the terms of the loan agreement. For example:

- Were payments made timely between the subsidiaries on the dates specified in the agreement?

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- Were penalties charged for any late payments?
- Were fluctuations in the prime rate being adjusted in a timely manner?

Get the recipient's bank account statements. There is a lengthy discussion on arm's length transactions in 26 CFR § 1.482-1 (Allocation of income and deductions among taxpayers).

Again, if after reviewing the documents an argument can be made in this area, then discuss with the audit supervisor and then forward the documents to Technical Support along with a memo explaining the auditor's position. If the Department cannot challenge the 80/20 test and there is no REIT involved, then the transaction(s) with the 80/20 will be honored and no audit adjustment will be made.

For more information, refer to the section "Arm's Length Transactions" in Audit Manual Chapter 24.

B. REIT - FINANCIAL GROUP

If the financial organization owns a real estate investment trust (REIT), then trace the dividends paid by the REIT to see if it is being sheltered from Illinois tax. A REIT federally files a Form 1120-REIT and is not included in the consolidated federal return. IITA § 203(e)(2)(D) defines the taxable income of a REIT as "real estate investment trust taxable income" which is Line 22 on the federal 2017 Form 1120-REIT. Also see IAC § 100.2405(c)(4). That line is net of the dividend paid deduction that the REIT receives federally on dividends that are paid. When the REIT is being used to shelter income of a combined group, the vast majority of the dividends will be paid to a REIT holding company (RHC). Normally the REIT has positive taxable income before distributing its income as a dividend For example, the REIT reports its taxable income before dividend on Line 20 of the federal 2017 Form 1120-REIT, andthen distributes all of the income as a dividend on Line 21b, making its REIT federal taxable income zero on Line 22. Without any federal taxable income, many REITs do not file in Illinois even though they may have an Illinois factor.

On the receiving side the RHC reports the dividends from the REIT as subject to federal tax, which would also be subject to Illinois tax. No Illinois subtraction modification applies to the REIT dividends received by the RHC, and so the REIT gets to deduct all of the dividends it pays from its federal taxable income, but the dividends received by the owner of the REIT are taxed both federally and for Illinois purposes.

On a unitary basis REITs are treated the same as any other corporation and therefore must meet the same unitary criteria under IITA § 1501(a)(27) and IAC § 100.9700. If the parent is the ultimate recipient of the REIT dividends, then the ownership test in IAC § 100.9700(e)

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is probably met. Of course, the other unitary requirements of IAC § 100.9700 would also have to be met for the REIT to be included in the unitary group.

If the RHC is owned by a bank holding company so that its income is apportioned under IITA § 304(c), then the taxpayer may shield the REIT dividends from Illinois taxation by arranging for the RHC to receive the dividends in a foreign country.

If the 80/20 test of the RHC cannot be challenged using the procedures previously stated, then Audit can focus on whether or not the REIT dividend paid deduction is allowable under federal rules. The deduction would not be allowable federally if Audit can show that the REIT does not meet the federal definition of a REIT, in which case Audit would make a federal change to taxable income under IITA § 203(e). This is not an IITA § 404 adjustment nor is Audit challenging the 80/20 test. The RHC will remain an 80/20 company outside the unitary group, but federal taxable income of the REIT will be increased by the disallowed federal dividend paid deduction.

The following are basic REIT qualifications that the Department could challenge.

- A REIT must have at least 100 shareholders. When the REIT is being used to shelter income of a corporation, most of the shareholders are officers and directors of the corporation who collectively receive a small amount of the REIT dividends with the bulk of the dividends going to the RHC.

- Shares of stock in a REIT must be transferrable.

- At least 75% of a REIT's gross income must be derived from rents from real property, interest on obligations secured by mortgages on or interests in real property, and gains on the sale of real property. Also, 75% of a REIT's net assets must be invested in real estate assets, cash, receivables, and government securities.

- The assets must have been transferred to the REIT through a written, legal agreement.

- The REIT must pay the parent for the assets it receives either through the issuance of cash, loans, stock, etc.

The above requirements are explained in more detail below. Review the REIT qualifications to see if there are any federal requirements that the Department can challenge.

For tax years ending prior to December 31, 2008, if a case can be made for an audit adjustment, then discuss with the audit supervisor and after forward pertinent documents to

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Technical Support along with a memo explaining the auditor's position, a short calculation of the tax effect, etc. Technical Support will then consult with Legal Services on whether or not to go forward with the proposed audit adjustment.

For tax years ending on or after December 31, 2008 (December 31, 2009, if a REIT is involved), apply the expanded Schedule 80/20 provisions rather than an alternative method.

Request some or all the following documents concerning the REIT:

- Loan Participation Agreement (may also be called or include a "Master Deed") or other asset transfer agreement along with a description of property transferred
- A detailed description of the process by which loans or other assets were identified for transfer to the REIT along with a description of how the actual transfer was made
- Minutes of meetings of the shareholders and board of directors of the parent or other affiliate of the REIT discussing the formation or operation of the REIT and RHC.
- Articles of Incorporation of the REIT
- Documents, correspondence or emails that discuss the formation of the REIT
- General ledgers of the REIT for each month of the audit
- Samples of journal entries
- Shareholder agreements and other documents relating to the transfer of REIT shares to the individual REIT shareholders
- Identity of the officers of the REIT and which offices they work out of
- Copies of agreements where the parent or affiliates of the REIT provide services
- Copies of Agreements with third parties on the providing of services
- REIT Bank Statements
- Minutes of meetings of the shareholders and board of directors of the REIT and RHC

Note: See attached Exhibit A for a list of additional possible questions.

1. REIT QUALIFICATIONS

a) The 100-Shareholder Test

IRC § 856(a)(5) provides that a REIT is an organization "the beneficial ownership of which is held by 100 or more persons." IRC § 856(b) provides that this condition must exist during at least 335 days of a taxable year of 12 months. Accordingly, in order for a captive REIT to fail this test, it must have fewer than 100 shareholders for at least 31 days during the taxable year. Short taxable years are covered under 26 CFR § 1.856-1(c). In addition, 26 CFR § 1.856-1(d)(2) provides for no "rules of attribution". Check to make sure that the REIT met the 100 shareholder test for each taxable year under

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these IRC sections. If the REIT fell short of the 100 shareholder minimum during the taxable year, it could be a basis for denying its REIT federal status.

b) Shares of REIT Stock Must be Transferable

IRC § 856(a)(2) provides that a REIT is an entity:

> The beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest.

However, every captive REIT will probably have some provision in its charter or trust agreement, or in a separate shareholder agreement, restricting the transferability of its shares in order to prevent its failing the 100-shareholder test. The IRS has taken the position that restrictions on transferability that are intended to ensure that the 100-shareholder test is met will not disqualify the REIT. However, obtain that provision from the taxpayer and review it. Any restriction on transferability that is not expressly stated to be applicable only to prevent failing the 100-shareholder test could be a basis for holding that the captive does not qualify as a REIT. If it is believed that there is such a restriction, then a copy of the shareholder agreement, charter or trust agreement should be forwarded to Technical Support for consultation with Legal Services.

c) Obligations Secured by Mortgages on Real Property

IRC § 856(c)(3) provides that an entity may qualify as a REIT only if:

> (3) at least 75 percent of its gross income (excluding gross income from prohibited transactions) is derived from -
>
> (A) rents from real property;
> (B) interest on obligations secured by mortgages on real property or on interests in real property;
> (C) gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(a)(1);
> (D) dividends or other distributions on, and gain (other than gain from prohibited transactions) from the sale or other disposition of, transferable shares (or transferable certificates of beneficial interest) in other real estate investment trusts which meet the requirements of this part;
> (E) abatements and refunds of taxes on real property;
> (F) income and gain derived from foreclosure property (as defined in subsection (e));
> (G) amounts (other than amounts the determination of which depends in whole or in part on the income or profits of any person)

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received or accrued as consideration for entering into agreements (i) to make loans secured by mortgages on real property or on interests in real property or (ii) to purchase or lease real property (including interests in real property and interests in mortgages on real property);
(H) gain from the sale or other disposition of a real estate asset which is not a prohibited transaction solely by reason of section 857(b)(6); and
(I) qualified temporary investment income[.]

In addition, IRC § 856(c)(4) provides that an entity may qualify as a REIT only if:

(4) at the close of each quarter of the taxable year –
(A) at least 75 percent of the value of its total assets is represented by real estate assets, cash and cash items (including receivables), and Government securities[.]

Briefly review the REIT assets to assure that the above qualifications were met.

d) Assets Must Have Been Transferred to the REIT

The assets must have been transferred to the REIT through a written, legal agreement (as opposed to an intercompany bookkeeping entry). Review the asset transfer agreement(s) to assure that there was a legal transfer of assets. It will be necessary to review the Loan Participation Agreement to see if this was done.

e) REIT Must Compensate the Parent for the Assets It Receives

When the REIT was originally organized it issued stock to the parent, and in return the parent transferred qualified assets to the REIT. The issue is subsequent transfers of assets after the initial REIT capitalization. When the parent transfers subsequent assets to the REIT, then the parent must receive some kind of compensation from the REIT. It could be additional shares of stock in the REIT, cash, loan, or notes receivable. If the parent transfers assets to the REIT for no compensation, then it could be argued that a sham transaction exists.

C. REIT – THREE-FACTOR GROUP

In this issue a three-factor unitary group establishes a REIT to own real estate for the unitary group. The REIT may not be a member of the consolidated federal return, but instead files a separate Form 1120-REIT. The REIT is owned by a REIT holding company (RHC) and receives the dividends issued by the REIT. The RHC is included in the consolidated federal return if it is incorporated in the U.S., but the issue is that the taxpayer

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arranges for the RHC to have greater than 80% of its property and payroll outside the U.S. This may be done by transferring to the RHC a foreign disregarded entity, or by setting up the RHC in a tax-haven country with minimal property or payroll. The REIT receives a federal dividend paid deduction on dividends that it issues the RHC, but the RHC receiving the taxable dividends is not subject to Illinois tax. In the past, IITA § 404 was used to reverse the tax effect of the transaction.

In order to challenge the transaction, it will be necessary to either:

- disprove the taxpayer's 80/20 test, or
- prove that the REIT does not meet the qualifications of a REIT under IRS rules.
    - In order to challenge the federal qualifications of the REIT, follow the REIT issue in the section above.
    - If the REIT does not meet the federal qualifications, then the REIT federal dividend paid deduction can be denied under IITA § 203(e) without challenging the 80/20 test of the RHC.

The 80/20 procedures are below:

1. 80/20 TEST – THREE-FACTOR FILERS

Perform the 80/20 test to determine if the 80/20 has 80% or more of its total business activity outside the U.S. Under IITA § 1501(a)(27) the test is applied in the same manner as the apportionment factor. The numerator for the 80/20 test is comprised of the 50 states and District of Columbia; no territories or possessions are included. Puerto Rico is not included. REF: IAC § 100.9700(c)(2)(A);

The 80/20 test includes only the property and payroll for three-factor companies. One factor companies such as transportation, insurance, and financial organizations use the same 80/20 formula they use for apportionment.

For taxpayer's required to use three-factor apportionment under IITA § 304(a), the 80/20 test would be computed as follows:

Property within the US	Payroll within the US
---	---
---	---
Total Property Everywhere	Total Payroll Everywhere

If either the property fraction or the payroll fraction has a denominator of zero, the sum of the fractions will be divided by one. REF: IAC § 100.9700(c)(1) & (2)(B).

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No intercompany eliminations are made before the 80/20 test. REF: IAC § 100.9700(c).

a) 80/20 Test - Property Factor

In determining the property factor for the 80/20 test, the numerator will consist of real and tangible property owned or rented in the U.S. and the denominator will be property owned or rented worldwide. Included property in the test should be one of the following:

- used
- available for use
- capable of being used in the taxpayer's business

Property excluded from the test should be one of the following:

- used in the production of nonbusiness income
- construction in progressr
- property that is permanently withdrawn from use

REF: IAC § 100.3350(a) and (b).

In applying the 80/20 test it must first be determined if the 80/20 actually owns or rents any property in the foreign country or the U.S. This can be determined by reviewing the balance sheet of the 80/20 federal pro forma. Small items may be expensed and not listed on the balance sheet. Therefore, a review of the Schedule M-1, Schedule M-3, or other deductions taken should be conducted to detect the items that should be included with property, which have been expensed. Occasionally, rent is included in other items such as management fees.

If the taxpayer claims rent expense, verify that the 80/20 is the actual lessee of the property by reviewing the lease agreement. If the agent of the 80/20 actually rented the property, then that rent cannot be included in the property factor of the test.

The Department has the statutory authority to attribute property owned by others and used by the taxpayer at no charge, or rented for a nominal rate to the taxpayer under IAC § 100.3380(b)(2). A fair market value rental rate can be calculated for any property used in relation to the 80/20's operations such as preparation of 80/20's books and records, storage and safekeeping of records, tax return preparation, etc.

However, the argument that the taxpayer should be deemed to rent the equipment that another person uses to perform services for the taxpayer was rejected by the ALJ in *Abbott Labs*, 98-IT-0304.

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b) 80/20 Test - Payroll Factor

The payroll factor for the 80/20 test will include all compensation paid by the 80/20 company during the taxable year. The figures for the payroll factor should come from the federal Forms 940 and 941. If the 80/20 has deducted or expensed any salaries and wages, verify that the individuals earning those salaries and wages are truly employees of the 80/20 as defined in IAC § 100.3100(b). If the taxpayer asserts that a foreign director or agent is an employee, it must be determined if they meet the definition of an employee. In order to be an employee, the individual performing services must have a legal relationship with the entity for which the services are being performed.

D. AN 80/20 COMPANY OWNING CAPITAL OR INTELLECTUAL PROPERTY

In this issue a unitary group composed of domestic retailers and/or manufacturers transfer substantial capital or intellectual property to a captive 80/20 company with minimal property and payroll located in a tax-haven country such as Bermuda. The 80/20 company and its federal taxable income are then excluded from the unitary group, but the interest and/or royalty payments made to the 80/20 are allowable federal expenses incurred by the unitary group which reduces unitary taxable income.

It is possible to disallow the 80/20 test for the captive recipient of the interest or royalty income and attempt to include the captive in the unitary group. Basically, if the captive 80/20 has minimal activity, then the taxpayer's 80/20 test can be disproven using the following methods:

- If the 80/20 is a three-factor company, then impute property of related domestic companies to the 80/20 captive under IAC § 100.3380(b)(2)
- If the 80/20 is a three-factor company, then attempt to show that officers or employees of domestic affiliates are providing substantial services to the 80/20, similar to the Illinois Appellate Court case in *Zebra Technologies Corp.*, 344 Ill. App. 3d at 481

1. APPLYING ZEBRA TECHNOLOGIES

In addition to applying the 80/20 rules discussed in the previous section, if the 80/20 is managing a substantial amount of intangible assets (i.e., trademarks and patents), then it may be possible to disprove the taxpayer's 80/20 test under *Zebra*.

With respect to intangible assets (i.e., trademarks and patents), certain actions are required in order to maintain these assets. In order for these assets to maintain their

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usefulness and allow the taxpayer to exploit them, the taxpayer must monitor the use of patents and trademarks by the licensee. These assets must also be registered with the appropriate federal and state agencies and must be protected against unlawful use by unrelated parties. These functions require a commitment of time and money on the part of the licensor. It is necessary to determine if these responsibilities remain with the licensor (80/20 company) or were contracted to the licensee (parent and affiliates).

Once the responsibilities of the various parties are determined, it is necessary to find out where these activities are actually taking place. The inquiry can focus in part on the ability of the foreign subsidiary to perform these duties. If the foreign subsidiary is a shell corporation with no real employees or office, it is reasonable to assume (based upon documentary evidence gathered that reveal that information) that the activities needed to maintain and protect the taxpayer's intangible assets are being done in the U.S. by the parent company and/or its unitary affiliates. Thus, if it is determined that the unitary group is performing these activities, the Department could disqualify the foreign subsidiary's 80/20 status. The following are suggestions to help analyze the 80/20 status:

- Ask for license agreements that give rise to the royalty or interest income
- Obtain services agreements detailing what the employee(s) of the 80/20 and parent or other affiliate do with respect to the 80/20 company's activities
- Request copies of any W-2s issued by the 80/20 company for the audit period
- Obtain sample ledgers that show the exact flow of income among the subsidiaries, what type of income is paid, by what entity to which other entity, how much, how it is accounted for, what dates the income changed hands, etc. (e.g., royalties, dividends, etc.)
- Obtain bank statements of the REIT and wire transfers from all companies involved with the payment of royalties, interest, or dividends
- Determine which entity filed patent/trademark applications, followed up with annual registrations, performed quality control, and protected or defended the patents or trademarks. If an outside law firm was employed, which entity oversaw its activities and paid the legal bills? Which entity approved or authorized settlements with respect to patent/trademark litigation?
- Obtain the complete federal Forms 5471 plus attachments
- Obtain complete federal Forms 1118 plus attachments
- An organizational chart for each year of the audit cycle for both the domestic and foreign operations might also help to understand the structure and activities
- Review board of directors' minutes of 80/20 subsidiary, affiliated companies, and the parent to reveal facts about the organization and its structure as well as purpose, intent, and actual activities
- Note any foreign property listed on SEC Forms 10-K
- Obtain copies of the leases of the overseas subsidiaries offices

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If enough facts can be gathered to show that a domestic parent or subsidiary is managing the assets of the 80/20 company, then it may be possible to argue that the taxpayer did not meet its burden to prove it is an 80/20 company.

E. NONCOMBINATION RULE COMPANIES- CAPTIVE INSURANCE COMPANY

For taxable periods prior to December 31, 2008, where the add-back modification for insurance premiums paid to a captive insurance company is not available, examine the captive insurance company. If the company does not meet the IRC's insurance company criteria, then it could be reclassified a regular three-factor company and included in the three-factor unitary group. This adjustment would result in a reallocation of base income to Illinois, the same as would the prohibited Section 404 adjustment.

The issue of captive insurance companies is fully developed in Audit Manual Chapter 31. Please refer to the section "Captive Insurance Companies" for more information.

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VI. EXHIBITS

A. EXHIBIT 1 – ADDITIONAL REIT QUESTIONS

The following are additional questions or follow-up questions on REITs.

1. Please provide the following documents and information about the REIT and REIT holding company (RHC):

- Is the REIT and RHC a corporation, trust, or association? Provide copies of the articles of incorporation and by-laws, trust instrument, or articles of association, whichever is applicable.
- Provide all documents that discuss, relate to, concern, or mention the tax and other business purpose attributed to the establishment of the REIT and RHC.
- Provide all minutes of any meetings of the incorporators, board of directors, and/or any executive committee that discuss the formation of the REIT and RHC or the transfer of assets to the REIT.
- Please identify all directors, officers, or trustees of the REIT and their relationship to the parent or other affiliates.
- Identify all employees of the REIT and provide their job description. If any of them are contemporaneously engaged by an affiliated company as either an employee, director, or officer, please state the same.
- Provide all minutes of any meetings of the board of directors and/or any executive committee of the parent corporation, REIT, or RHC concerning the declaration of dividends for REIT common and preferred shares.
- Provide a copy of the REIT's annual report and audited financial statements.

2. Please provide the following documents and **information about preferred and common shares issued by the REIT** for each year in the audit period unless otherwise requested:

- Describe the nature of the consideration received by the REIT for the preferred and common shares. Provide a copy of any written offers made to individual shareholders.

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- Describe the rights obtained by each shareholder and any restrictions on transfer of ownership. Provide copies of any shareholders agreements.

- Identify the common and preferred shareholders of the REIT and state whether they were employed by or otherwise affiliated with the parent or its subsidiaries.

3. Please provide the following documents and information about the assets held by the REIT for each year in the audit period unless otherwise requested:

- List the assets owned by the REIT.

- List the holders of real estate mortgages in which the REIT owns an interest and the REIT's percentage interest in each.

- Did the REIT purchase loan participation interests from a related company? If yes, what was the nature of consideration paid by the REIT? Provide copies of any loan participation agreements.

- Describe in detail the process by which loan participation interests were identified for transfer to the REIT. Identify the individuals who made the decision to transfer the loan participations to the REIT.

- Did the REIT purchase loan participation interests from an unrelated third company? If yes, what was the nature of consideration paid by the REIT?

- Which entity managed the assets owned by the REIT?

- Which entity prepared the REIT's journal entries, financial statements, and tax returns?

4. Provide the following documents and **information about income and expenses reported in the REIT's federal income tax return** (Form 1120-REIT) for each year in the audit period unless otherwise requested.

- Describe all of the REIT's sources of income from related and unrelated parties.

- Describe any and all services provided to the REIT, including the identity of the service provider(s) and the service provider(s)'s relationship to the REIT. Include copies of service agreements.

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- State the amount of consideration paid by the REIT for each of the services described in the preceding information request.

- State the amount of REIT distributions paid to each shareholder and list dates of distribution. Include copies of Forms 1099-DIV issued to each shareholder.

5. Provide the following documents and **information about the REIT's cash management system** for each year in the audit period unless otherwise requested:

- Provide a Statement of Cash Flows, which summarizes operating activities, investing activities, and financing activities.

- Who is responsible for making decisions concerning the REIT's operating cash flows? Specifically:

  - Cash Inflows - collections from customers, collection of interest and dividends, and collections of other operating receipts.

  - Cash Outflows – payments to suppliers, payments to employees, payment of interest, payment of taxes, other operating cash payments.

- Who is responsible for making decisions concerning the REIT's investing activities? Specifically:

  - Cash Inflows – sale of assets.

  - Cash Outflows – purchase of assets.

- Who is responsible for making decisions concerning the REIT's financing activities? Specifically:

  - Cash Inflows – borrowing cash from creditors and issuing shares of the REIT.

  - Cash Outflows – repayment of creditors, repurchase of REIT shares, and payment of dividends.

- How often did the REIT record loan participation interest income on its financial statements: daily, weekly, monthly, or annually?

- When the REIT recorded loan participation interest income on its financial statements, did it register an account receivable or cash? What percentage

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of loan participation interest income was recorded as an account receivable and what percentage was recorded as cash?

- How often was cash transferred from the parent company to the REIT: daily, weekly, monthly, quarterly, or annually?
- How often was cash transferred from the REIT to the RHC: daily, weekly, monthly, quarterly, or annually?
- When the REIT receives cash, is it deposited into a central cash management system for the affiliated group, or into a separate bank account maintained by the REIT?
- How much time elapses between the receipt of cash by the REIT and the disbursement of that cash as payment to a related company for a loan participating interest or a cash dividend on common or preferred shares?

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B. EXHIBIT 2 – LEGISLATIVE HISTORY

1. INITIAL 404 ADJUSTMENTS

The Audit Bureau started to slowly assert the authority to make the 404 adjustments in the late 1980s after approval and promised support from the Director. Initially, Audit restricted its pursuit to transactions between companies that were part of the same federal consolidated group, but under a different unitary group for Illinois purposes, since the transactions might not have been arm's length in nature. The first adjustments went after interest-free or minimal-interest loans between affiliated companies of separate unitary groups. As time passed, many of the 404 adjustments approved were for what would eventually be remedied by the 80/20 add-back modifications.

IITA § 404 Reallocation of Items originally contained only subsection (a) which states:

> (a) If it appears to the Director that any agreement, understanding or arrangement exists between any persons which causes any person's base income allocable to this State to be improperly or inaccurately reflected, the Director may adjust such items of income and deduction, and any factor taken into account in allocating income to this State, to such extent as may reasonably be required to determine the base income of such person properly allocable to this State.

Effective August 29, 2008, P.A. 95-0948 added subsection (b) to IITA § 404 which states:

> (b) The Director may not make an adjustment to base income under this Section that has the same effect as retroactively applying any amendments to this Act made by P.A. 93-0840, P.A. 95-0233, or P.A. 95-0707.

2. IMPACT OF P.A. 95-0948

In 2004, the Legislature attempted to close a number of tax loopholes by enacting P.A. 93-0840, which required the add-back of deductions for interest and intangible expenses paid to a person who would be a member of the same unitary business group as the taxpayer if not for the 80/20 test. The new provisions are implemented on Schedule 80/20 Related Party Expenses and are effective for tax years ending on or after December 31, 2004. P.A. 93-0840 contained language expressly stating that it did not preclude adjustments under IITA § 404 for years after its effective date, providing that those adjustments were made pursuant to regulations.

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In 2007, the Legislature passed P.A. 95-0233 as amended by P.A. 95-0707, which expanded the use of the Schedule 80/20 form to include:

- interest and royalty payments made to domestic companies that apportion under different subsections of IITA § 304 (noncombination rule companies),
- premiums paid to captive insurance companies for tax years ending on or after December 31, 2008, and
- dividend payments made by a real estate investment trust (REIT) starting for tax years ending on or after December 31, 2009.

IAC § 100.2430 was amended effective January 23, 2009, for these new provisions.

For tax years prior to the effective date of P.A. 93-0840, the Department sometimes asserted its authority under Section 404 to close the same loopholes that the Legislature intended to close with the above acts. In effect, the Department was using Section 404 to apply certain provisions of Schedule 80/20 prior to its effective date, and doing so without regulations. Some taxpayers argued that these actions were contrary to P.A. 93-0840, and P.A. 95-0948 was enacted to clarify that the Department lacks authority to use Section 404 to make adjustments in situations similar to those addressed in P.A. 93-0840 and P.A. 95-0233 in years prior to their enactment.

3. EXPLANATION AND DIRECTION FOR 404 AUDITS GOING FORWARD

Under P.A. 95-0948, effective August 29, 2008, the Department cannot make any Section 404 adjustments to base income which would have the same effect as retroactively applying the add-back provisions which were added to the Illinois Income Tax Act by P.A. 93-0840, 95-0233 or 95-0707. The add-back provisions involve modifications for interest, royalties and other intangibles paid to an 80/20 company (added by P.A. 93-0840) or to a company which is excluded from the combined return due to the noncombination rule (added by P.A. 95-0233) and dividends paid by real estate investment trusts (REITs) (added by P.A. 95-0233 and P.A. 95-0707).

4. IMPACT OF P.A. 100-22

Effective July 6, 2017, P.A. 100-22 modified the unitary business group (UBG) definition in IITA § 1501(a)(27)(B). It repealed the noncombination rule and expanded the definition of “United States” to include the outer continental shelf (OCS) for taxable years ending on or after December 31, 2017. This is a major adjustment to how auditors determine the UBG and combined apportionment, and

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eliminates the related-party expense modifications for noncombination companies for the applicable tax periods. Due to intercompany eliminations, many transactions that required 404 adjustments between unitary domestic companies should not be necessary for the applicable periods.

For more information, see Audit Manual Chapters 23 for UBGs, 24 & 25 for modifications, and 27 for apportionment.

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AMENDED RETURNS AND CLAIMS

ISSUED 11/2014
Revised 10/2019

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I. PURPOSE

The purpose of this chapter is to provide the auditor with a general understanding of the policies and procedures to follow when the taxpayer is required to file an amended return to report an increase in liability or claim a refund.

II. REFERENCE SOURCES

The IITA, UPIA and IAC can be accessed either through the IDOR website at https://www2.illinois.gov/rev/research/legalinformation/Pages/default.aspx or under Work Areas>Audit>Reference Material on the Sp•IDOR Web.

A. Illinois Income Tax Act (IITA)

Section 506 Federal Returns
Section 902 Notice and Demand
Section 903 Assessment
Section 904 Deficiencies and Overpayments
Section 905 Limitations on Notices of Deficiency
Section 909 Credits and Refunds
Section 910 Procedure on Denial of Claim for Refund
Section 911 Limitations on Claims for Refund
Section 911.2 Refunds withheld; tax claims of other states
Section 912 Recovery of Erroneous Refund

B. Uniform Penalty and Interest Act (UPIA)

Section 3-2(d)
Section 3-2(e)

C. Illinois Administrative Code (IAC)

Section 100.2250 Net Operating Losses Occurring Prior to December 31, 1986, of Unitary Business Groups: Treatment by Members of the Unitary Business Group: Deadline for Filing Claims Based on Net Operating Losses Carried Back from a Combined Apportionment Year
Section 100.5030 Taxpayer's Notification to the Department of Certain Federal Changes Arising in Federal Consolidated Return Years, and Arising in Certain Loss Carryback Years
Section 100.5240 Claims for Credit of Overpayments
Section 100.5260 Combined Amended Returns
Section 100.9100 Notice and Demand
Section 100.9200 Assessment
Section 100.9210 Waiver of Restrictions on Assessment
Section 100.9300 Deficiencies and Overpayments
Section 100.9400 Credits and Refunds
Section 100.9410 Limitations on Claims for Refund
Section 100.9420 Recovery of Erroneous Refund

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D. Publications and Bulletins

Informational Bulletin FY2005-10 Refund Claims for RAR Liabilities Paid Under Amnesty
Informational Bulletin FY85-0011 Combined Return and Inter-Company Offsets for a Unitary Business

E. Tax Forms

Form IL-1040-X	Amended Individual Income Tax Return
Form IL-1120-X	Amended Corporation Income and Replacement Tax Return
Form IL-1041-X	Amended Fiduciary Income & Replacement Tax Return
Form IL-1065-X	Amended Partnership Replacement Tax Return
Form IL-1120-ST-X	Amended Small Business Corporation Replacement Tax Return
Form IL-990-T-X	Amended Exempt Organization Income & Replacement Tax Return
Form IL-941-X	Amended Illinois Withholding Income Tax Return
Form IL-1023-C-X	Amended Composite Income and Replacement Tax Return (for tax years ending prior to December 31, 2014)
Form IL-843	Amended Return or Notice of Change in Income (for tax years ending before December 31, 2006)

These sources can be accessed on the IDOR website at
https://www2.illinois.gov/rev/forms/Pages/default.aspx

III. GENERAL INFORMATION

A. Mailing Address for Original Signature Amended Returns

Field Personnel

IT Audit Planning
Attn: Barry Stout
WIB
MC 3-327
101 West Jefferson Street
Springfield, IL 62702

In-house staff (Discovery or Fed/State Exchange)

Supervisor of the Audit Clerical Unit
Place in “Returns to be Copied or Scanned” tub

B. Amended Forms Available

The appropriate form prescribed by regulation:

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IL-1040-X Amended Individual Income Tax Return (for tax years ending 2007 or earlier use the 10/08 revision of Form IL-1040-X. For tax years 2008 or after use the Form IL-1040-X for the year you are amending.)
IL-1120-X Amended Corporation Income & Replacement Tax Return (for a tax year ending on or after December 31, 1986. For tax year ending prior to December 31, 1986 use IL-1120-X-PY.)
IL-1041-X Amended Fiduciary Income & Replacement Tax Return (for a tax year ending on or after December 31, 2007)
Il-1065-X Amended Partnership Replacement Tax Return (for a tax year ending on or after December 31, 2006)
IL-1120-ST-X Amended Small Business Corporation Replacement Tax Return (for a tax year ending on or after December 31, 2006)
IL-990-T-X Amended Exempt Organization Income & Replacement Tax Return (for a tax year ending on or after December 31, 2007)
IL-941-X Amended Illinois Withholding Income Tax Return
IL-1023-C-X Amended Composite Income and Replacement Tax Return (for a tax year ending on or after December 31, 2007 through December 31, 2013)
IL-1000-X Amended Pass-Through Entity Payment Income Tax Return (for a tax year ending on or after December 31, 2008 through December 31, 2013)
**Per instructions on the IL-1000-X, claims for refunds for payments made that were reported (or should have been reported) to partners, shareholders, or beneficiaries as amounts paid on their behalf cannot be processed on this form. The partners, shareholders, or beneficiaries must claim these amounts on their own tax returns.

(For tax years ending prior to those noted above for IL-1041-X, IL-1065-X, IL-1120-ST-X, IL-990-T-X and IL-1023-C-X, use Form IL-843, Amended Return or Notice of Change in Income)

The above forms are valid for overpayments based on federal changes, payment of a tentative carryback adjustment and Illinois changes.

IV. APE SPECIFIC LAW APPLICATIONS

An amended return is filed to report changes to a previously filed, processable return. The changes can occur from a state or federal change that affects items used to compute Illinois net income, net loss or credits such as:

- Amendment of a federal income tax return
- An adjustment made by the IRS
- Any other recomputation or redetermination

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A. Amended Return Handling

There are specific sections of the Illinois Income Tax Act that must be followed in the handling of amended returns contingent on whether the return reports additional tax due or an overpayment. If amended returns are filed reporting additional tax due and the liability is not fully paid, IITA §§ 902, 903 or 905(e) dictate when the statute expires for either issuing a notice of deficiency or notice and demand, contingent on the situation. The time period for issuing a notice and demand cannot be extended with a waiver of the statute of limitations. Also, a notice of lien must be filed within 3 years of assessment date, which is the date the amended return is filed or the IL-870 is signed (IITA § 1101(d)).

Amended returns are received by the Department reporting federal changes, carrying back losses, correcting errors on the returns, reversing adjustments from a completed audit, etc. They report additional tax due, claim a refund of tax paid or change some part of the return with no tax effect. If the amended returns cannot be verified by the Account Processing Bureau, they are forwarded to Audit Planning for determination on how to handle. Refer to Chapter 20 Income Tax Audit Procedure.

Amended returns claiming refunds are on occasion processed and the refunds issued prior to referral for verification. The refund is issued to limit the amount of interest paid to the taxpayer on the refund. These types of amended returns may be assigned as paid claim verification. If all or part of the refund is erroneous, the statute for erroneous refunds will apply (IITA § 912).

The auditor could receive large numbers of amended returns with some reporting overpayments and some reporting underpayments with a net overpayment or net balance due which may or may not be fully paid. Amended returns could be received from the taxpayer reporting RAR changes or carrying losses regarding periods for which the audit is still under appeal in Administrative Hearings, Tax Tribunal or Circuit Court.

1. Statute of Limitations

Refer to Chapter 21 Due Dates/Extensions/Statute Control.

The statutes of limitations never prevent the Department or the taxpayer from correctly computing any item of income, deduction, addition, subtraction, credits or payments for a taxable year. They only prevent one party from forcing the other party to make a payment.

2. Amended Returns Filed by the Taxpayer

At times, the taxpayer may file one or more amended returns for the years being audited. It is important for the auditor to be aware of any amended returns which have been filed since they will have to be incorporated into the audit file. Failure to

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incorporate the amended returns may result in the audit being returned from Technical Review.

Once an audit has been assigned, the auditor should periodically check GenTax for work items related to the years that may impact the audit period. This check is necessary to determine if there have been amended returns attached to the audit for the years involved. Refer to Chapter 20 Income Tax Audit Procedure for more information.

For audit purposes, the processing of amended returns can fall into one of two categories.

a) Amended Returns Received by Account Processing

When Account Processing receives an amended return a work item is created in GenTax. If there is an audit indicator on the account, the hard copy of the return will be forwarded to Income Tax Audit Planning. Audit Planning will then contact either the Field Supervisor and/or the Auditor assigned to the audit and check on the audit progress. If the audit is in the early stages, the amended returns will be added to the current audit as attachments in GenTax. If the audit is in the final stages, a "new" audit will be created showing the attached amended returns.

Discovery-
Do not order work item before Planning receives it from Processing. Clerical will take to Planning and then it will be forwarded to the assigned auditor.

Refer to Chapter 20 Income Tax Audit Procedure, Reviewing Tax Returns for Column A Determination, Addressing Work Items (Section IV.C.1) for procedures.

b) Amended Returns Received by the Auditor

When an auditor receives amended returns from the taxpayer during an audit, any amended return that affects the audit period will be included in that audit. These amended returns should then be mailed to Income Tax Audit Planning where they will be scanned and added to the audit as attachments in GenTax. A file folder is created to hold these amended returns and sent to Files for storage.

3. Initial Review and Perfecting of Amended Returns

The following is a list of steps that should be taken when examining amended returns:

1. Verify that each amended return is signed by an authorized person.

   If not signed, return to taxpayer immediately for signature. Without information to the contrary, we presume the person who signs the return is authorized to do so pursuant to IITA § 503. Each return should also be dated by the taxpayer. The

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auditor should inform the taxpayer of the amount of time left before the statute expires.

Cases where amended returns were received and not handled immediately have caused many problems. When the auditor reviewed them and discovered that they were not signed, the statute for amending the return had expired. Cases like this are not good for taxpayer relations.

2. Verify that each amended return downfoots correctly

   This can be accomplished by data-entering the amounts from the most recently filed or adjusted return for the year as reflected in GenTax in Column A of the Auditor's Report. The "As Corrected" line amounts should be entered in Column C of the Auditor's Report. If the amended return was properly completed, Column B of the Auditor's Report should match the reported changes. If the amended return downfoots and shows the correct amount of additional tax due, it can be processed under normal procedures with the audit file.

3. Confirm that the amended return does not contain any miscalculations, entries on wrong lines, or other obvious inaccuracies.

   Have the taxpayer make the necessary corrections to the amended return before you accept it. Verify that all the required schedules and supporting documentation are attached to the amended returns.

4. Verify that each amended return claiming a refund is filed within the statutory period.

   All amended returns claiming an overpayment should be analyzed to determine if they have been filed within the statutory period. Refer to Chapter 21 Due Dates/Extensions/Statutory Control. If the statute of limitation has expired for filing a claim for refund, the auditor should request that the taxpayer withdraw the original claim for refund by signing an EDA-153. If they will not, the amended return should be submitted with the audit file for the issuance of a formal claim denial.

5. Verify that each amended return reporting additional tax due is fully paid. If not, check to determine if the statute for issuing a notice and demand for payment has expired.

   - If a payment for the total liability, including tax, interest and applicable penalty, is remitted with the amended return, a Notice and Demand is not required.

   - If all of the tax, penalty and/or interest is not paid, the auditor should determine if the statute has expired for issuing a notice and demand for

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payment. If the statute for issuing the Notice and Demand has not expired, refer to Notice and Demand Procedure for processing instructions. Refer to Chapter 21 Due Dates/Extensions/Statutory Control for determining Notice and Demand limitations.

6. Frequently, a change will encompass multiple tax years, and result in amended returns reporting both overpayments and underpayments. Refer to Chapter 42 Penalty and Interest, Offsets Between Years on how to process audits including tax years with underpayments and overpayments.

   Amounts offset between APEs not on the same IL-870 can only be offset at the discretion of the Department. A taxpayer who files multiple amended returns and offsets overpayments against underpayments without prior consent of the Department is not entitled to abatement of any penalty or interest that results from the Department's failure to comply with the request. If you agree to the taxpayer's request to offset in this situation, your consent should be noted in the auditor's comments.

7. Amended returns received from the taxpayer by the Field Auditor are considered officially filed when received by the auditor, since the Field Auditor is an agent of the Department. After perfecting the return, write "Received by IDOR" along with the date and the auditor's initials on the front page at the top right hand corner of each "original" and on the taxpayer's file copy. This is a very important step for statutory control purposes.

8. Keep a complete copy of the amended return(s) for the audit file. The auditor will work from this retained copy to verify line items and ensure the changes were properly reported on the amended return(s).

4. GenTax Information

Amended Return Indicators

There may be information on GenTax indicating that amended returns require processing in the audit. An auditor should look at the Audit Springboard to search for key information pertaining to amended returns.

At the bottom of the Audit Springboard is the **TASK** tab. If amended returns are described in this field, they are to be addressed for possible inclusion in the audit.

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The auditor should also check for attachments in the **ATTACHMENTS** tab located under the **CRM** tab on the Audit Springboard. Select **ATTACHMENTS** to see if amended returns (or other important information) are displayed. Select the blue hyperlink, to view the attachment.

Then Select the **View File** tab or the blue hyperlink under History.

A box will then appear allowing you to Open or Save the file.

Once opened, the return can be printed to put in the audit file.

Amended returns are also referenced in **NOTES** located under the **CRM** tab on the Audit Springboard.

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Additional information (attachments) could be present stating that the amended return has NOT been processed. Therefore, the return will not show on GenTax at the Return level, but such a return would be included as part of the audit.

Occasionally an amended return is so recent, or somehow has not yet been referred to Audit Planning, that information may not be found on the Audit Springboard. Audit Planning staff is responsible for entering the Description info and for scanning returns to create Attachments when unprocessed returns are referred to Audit.

One last clue that an amended return may exist is when another payment appears in the detail of transactions for any APE. This payment may represent the presence of an amended return.

The auditor should also look for **Work Items** on GenTax to see if these require addressing in the audit. Refer to Chapter 20 Income Tax Audit Procedure, Addressing Work Items.

5. Amended Return was not Properly Completed and Cannot be Processed as Filed.

a) Column A amounts on the Amended Return do not match Department records of return line items as last reported on or adjusted in GenTax.

This might occur:

i. if the original return contained a “math error” that was corrected during processing, but not reflected on the amended return; or

ii. if the taxpayer was previously audited by the Department, but the amended return starts with line entries from the original return instead of the audited amounts.

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In either case, it will be necessary to prepare an Auditor's Report starting with GenTax line amounts (i.e., Department records as last reported or adjusted) in Column A. Enter the reported changes in Column B. If the additional tax on the Auditor's Report matches the additional tax liability on the amended return, the correct statutory deficiency was self-assessed. Then, the Auditor's Report will serve as the processing document for the changes. Attach the Auditor's Report to the front of the amended return and write at the top "*For Processing Purposes only – Refer to amended return for taxpayer signature*".

However, if the results in Column C produce tax due or overpaid in addition to the tax shown on the amended return, only the difference between the statutory deficiency (Column B of the Auditor's Report) and the tax amount that was previously self-assessed on the amended return will be entered on Form IL-870. Form EDA-122 Notice of Proposed Deficiency must be issued with Form ICB-1. Remember to record additional tax resulting from RARs separately from other audit adjustments on the PROD-1. For federal changes where a Notice of Deficiency is required and the statute of limitations on the original return has already expired, the Notice of Deficiency must be issued within two years from the date the amended return was filed (IITA § 905(e)), and the amount of the deficiency is limited to the additional tax resulting from the federal changes.

b) Amended Return is Filed for a Tax Year with an Unagreed Audit that is Currently under the Jurisdiction of ICB, Administrative Hearings, Tax Tribunal or in Circuit Court.

Planning will notify the ICB conferee or the litigator in Administrative Hearings/Tax Tribunal/ Circuit Court that amended returns have been filed for a tax period under their jurisdiction. Since Column A of the amended return will probably not reflect the line amounts from Column C of the unagreed Auditor's Report, the amended return will most likely not be processable. Contingent on which audit issue(s) were not agreed, it may or may not calculate the true additional tax liability resulting from the changes. The auditor will prepare an Auditor's Report to compute the taxpayer's correct liability resulting from the changes. The previously audited figures from Column C of the unagreed Auditor's Report will be entered as the starting point in Column A of the Auditor's Report. (Refer to Chapter 20 Income Tax Audit Procedure on how to obtain figures from unagreed Auditor's Reports.) The reported changes from the amended return will be reflected in Column B. If the statutory deficiency on the Auditor's Report matches the increase in tax on the amended return, the correct additional tax was self-assessed on the amended return and a Notice of Deficiency will not be required.

If Column C results in tax due or overpaid in addition to the tax shown on the amended return, only the difference between the statutory deficiency (Column B of the Auditor's Report) and the tax amount that was previously assessed on the amended return will be entered on Form IL-870. Form EDA-122 Notice of Proposed

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Deficiency must be issued with Form ICB-1. Remember to record the additional tax resulting from RARs separately on the PROD-1. For federal changes where a Notice of Deficiency is required and the statute of limitations on the original return has expired, the Notice of Deficiency is limited to the additional tax resulting from the federal changes. The Notice of Deficiency must be issued within two years from the date the amended return was filed (IITA § 905(e)). If the audit is currently in Administrative Hearings or Tax Tribunal on protest of a prior Notice of Deficiency, IITA § 906 prohibits the issuance of an additional Notice of Deficiency unless it is issued before the Administrative Hearing or Tax Tribunal decision becomes final. Consult with the litigator assigned to the case about issuing the Notice of Deficiency.

6. Notice and Demand Procedure

If the auditor determines that a manual Notice and Demand is required, the amended return must be referred to the Audit Perfection supervisor. If the amended returns are the subject of the entire audit and no further work is required by the auditor, the case should be closed as an admitted liability or admitted liability/paid and submitted to the Supervisor for review. The auditor and supervisor should make sure that a note is attached to the outside of the track folder that states "NOTICE AND DEMAND STATUTE RUNNING" (if less than 6 months remain) with the date the statute will run prominently displayed. The file should be tracked to Audit Perfection, Attention: Supervisor. These cases will be handled on a priority basis so that the notice and demand is issued on time.

If the audit is not near completion but a notice and demand must be issued to protect the admitted liability statute (IITA § 903) of amended returns, the auditor must do the following:

a. Obtain a new audit track for the amended return from Audit Planning. Transmit the amended return and supporting documentation to Audit Perfection, Attention: Supervisor. Prominently display the statute date and the words "NOTICE AND DEMAND STATUTE RUNNING" on the outside of the folder. The auditor should keep a copy of the amended return and any documentation sent to Audit Perfection for the file. Update the EDC-5 to reflect that the amended return(s) were sent to Springfield for processing.

b. If necessary, prepare an Auditor's Report listing the correct numbers in Column A, the changes in Column B and corrected amounts in Column C. Compare those results with the amended return. If the amount of additional tax due agrees with the amount reported on the IL-1120-X, attach the Auditor's Report to the amended return with a note instructing the adjuster to process the Auditor's Report. A Notice and Demand can only be issued for the admitted liability. Therefore, the additional tax due reported by the taxpayer must agree with the additional tax calculated on the Auditor's Report.

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c. If the auditor determines that the amended return is correct as filed, an Auditor's Report is not required. A note should be attached informing Audit Perfection to process the amended return as filed and issue a Notice and Demand.

d. Once the amended return is adjusted in the system, Audit Perfection personnel should send an email to the auditor informing them of the adjustments.

e. If claims are going to be processed first, but there are errors on the claims, the auditor will have to perfect the claims. Refer to Initial Review and Perfecting of Amended Returns.

B. Amended Returns Reporting Federal Changes

A federal change may result from:

- An IRS adjustment to the taxpayer's federal return
- An IRS audit examination (RAR)
- The taxpayer filing a federal amended return that has been accepted by the IRS

IITA § 506(b) discusses federal changes and requires taxpayers to notify the Department of such changes by filing an amended return within 120 days after the change is finalized (agreed to, or finally determined) with the IRS. When the federal change results in an overpayment, IITA § 911(b) allows a refund claim to be filed for the overpayment that results from the federal change at any time within 2 years after the federal change notification is due.

Acceptable Proof of Federal Finalization includes, but is not limited to the following:

- Copy of a refund check received from the IRS
- Account transcript from the IRS or examiner's report
- IRS Letter 525 – Examination Report
- Form 886-A, *Explanation of Items* – used in all unagreed cases (optional for agreed cases). Form 886-A is an attachment to formal RAR.

Revenue Agent Report (RAR)

- Form 4549, *Income Tax Examination Changes* – for agreed cases for individuals and corporations
- Form 4549-A, *Income Tax Examination Changes (Unagreed and Excepted Agreed)* – for individual and corporation income tax cases. (NOTE: This form does not require the taxpayer's signature for consent to assessment and collection.)

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- Form 4605, *Examination Changes – Partnerships, Fiduciaries, S Corps, &Interest Charge Domestic International Sales Corporations* – for reporting examination changes in partnerships, fiduciaries, small business corporations and domestic international sales corporations.

- Form 4605-A, *Examination Changes – Partnerships, Fiduciaries, Small Business Corps. & Domestic Intl Sales Corp (Unagreed and Excepted Agreed)* – for unagreed and excepted agreed cases for partnerships, fiduciaries, small business corporations and domestic international sales corporations.

- Form 870, *Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment*.

Unacceptable Proof of Federal Finalization:

- Issue Resolution Agreement (IRA) – The IRA is issued during the Compliance Assurance Process (CAP). The form identifies tax issues prior to the filing of a return.

- Closing Letter – The Closing Letter is issued under The Mutual Agreement Procedure (MAP). Recommendations made in a closing letter will either be addressed in an amended return or included in the current years return. If an amended return is prepared, the normal post-filing examination procedures would apply.

A federal change opens a new statute of limitations period in Illinois for a tax year, even if the federal change is made too late for a federal deficiency to be assessed for the tax year. *Peoria and Pekin Union Railway Co. v. IDOR*, 301 Ill.App.3d.736 (1999).

The following procedures are to be followed when a taxpayer informs the auditor of a federal change that has been finalized with the IRS but has not yet been reported to the Department.

1. For Illinois purposes, the taxpayer is obligated to report the federal change, whether or not it creates a change in Illinois income tax liability.

2. The auditor should not accept the RAR or related summary workpapers. Instead the auditor should ask the taxpayer to report the federal change on the appropriate amended Illinois return. The auditor does not prepare the amended return. Notification as required under IITA § 506(b) occurs when the taxpayer files an Illinois amended return to report finalized federal changes. IAC § 100.9400(f)(6) expressly specifies the amended returns that refund claims must be filed on. **The federal change is considered unreported if no amended return has been filed**. When a federal change is unreported, a Notice of Deficiency (NOD) may be issued at any time (IITA § 905(d)).

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3. The taxpayer should give the amended return(s) directly to the auditor to expedite handling. A return is considered officially filed with the Department on the date it is presented to an auditor because he/she acts as an agent of the Department. The two-year statute of limitations to issue a Notice of Deficiency also commences to run on the "received date" of the return (IITA § 905(e)). An executed Form IL-872 may be obtained to extend the statute of limitations on a federal RAR, if necessary.

4. The auditor must "perfect" each amended return upon receipt. Refer to Initial Review and Perfecting of Amended Returns.

5. After perfecting the return, send the amended return(s) (taxpayer's original signature affixed) with the attached remittance and a cover sheet to the appropriate section. (Refer to General Information section.) In addition, send the appropriate designee an email identifying the audit GenTax ID and list each of the documents by tax year. The email can be printed to serve as a cover sheet. A confirmation email will be returned to the auditor to acknowledge receipt. Refer to Chapter 20 Income Tax Audit Procedure, General Shipping/Mailing Procedures.

6. Payments will be posted to the taxpayer's GenTax account. The amended returns will be visible on the Audit Springboard under "Attachments" after they are scanned into GenTax. The original document will be case filed and sent to Taxpayer Records for storage to comply with records retention requirement. **No amended return of any type that contains a taxpayer's original signature should be left in an audit file under any circumstances**.

7. Each amended return for the audit period must be worked as a part of your audit assignment. Auditors must analyze each federal adjustment and its detailed explanation to ensure that all federal changes that impact the Illinois return were properly accounted for on the amended return. Be sure to focus on any federal adjustments that may impact any capital loss, an Illinois net loss (including both the loss year and the carry years), modification, apportionment, Illinois tax credits, etc.

8. Each amended return must be verified and either accepted as filed or adjusted as necessary. That also includes amended returns showing no tax change. If a claim was filed, the auditor must approve the refund in total, deny it or partially reduce it to reflect the allowable portion of the claim. The claim can also be withdrawn in writing by the taxpayer.

9. Examination technique, exceptions noted, and any adjustments made to the amended return must be fully explained in the Auditor's Comments.

10. If the federal change encompasses tax years within or adjoining your audit assignment, the period can be expanded to include those tax years with your current audit. Be cognizant of the statute of limitations issues and prepare any necessary Form IL-872.

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Discuss the matter with the RAS, who will approve and make the necessary changes to the period and statute on GenTax.

11. If the federal change year(s) is outside of the audit period or involves tax years preceding the audit period, complete Form SC-137 to request a new assignment.

1. Federal RAR Amended Return Examples

The following procedures apply if the amended return self-assessed an additional tax liability resulting from federal changes.

- **If the amended return can be processed as filed** and additional audit adjustments are required, the starting point for Column A of the Auditor's Report will begin with line amounts from the "As Corrected" column of the amended return. Necessary corrections to (or omissions of) federal changes reported on the amended return, along with audit adjustments, will be entered in Column B of the Auditor's Report.

- **If federal changes were underreported on the amended return**, line amounts from the "As Corrected" column of the amended return will be entered as Column A of the Auditor's Report. Any necessary corrections to the reported changes will be shown with other audit adjustments in Column B of the Auditor's Report. An IL-870 showing the statutory deficiency must be signed by the taxpayer to assess the additional tax and any applicable late payment penalty resulting from corrections to the federal change.

  Form EDA-122 Notice of Proposed Deficiency must be issued with Form ICB-1. Remember to record the additional tax resulting from the RAR separately on the PROD-1.

- **If the amended return incorrectly assessed more tax than was actually due**, the tax amount that was overassessed will be shown on Form IL-870 as a statutory decrease (if there are no other changes in the audit). Since this represents a reduction to the additional liability on the amended return but not a claim filed by the taxpayer, no proposed notice will be issued. If the total liability on the amended return remains overpaid after adjustments, the excess remittance can be applied to offset the liabilities for other tax years in the audit period, or refunded to the taxpayer after the audit is processed.

If the federal change produces a refund, confirm that the amended return was filed within the statutory period (2 years and 120 days of the IRS finalization date). If it was timely filed, the audit can be completed in a normal manner. Examine the federal changes to verify that all adjustments were properly reported. If it was filed after the statute had already expired, the claim will be totally denied. Select the situation below that is applicable to the audit and follow the process.

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- **If the claim is totally allowable and approved by the auditor with no other audit adjustments**, the taxpayer's amended return will be processed as filed. No Auditor's Report or Form IL-870 will be prepared. The overpayment can be utilized to offset liabilities in other years in the audit period or refunded.

- **When issues reported on the taxpayer's claim are correct but other audit adjustments increase the tax liability**, the auditor must prepare an Auditor's Report to determine the correct amount that is overpaid and refundable to the taxpayer. Column A of the Auditor's Report will start with GenTax line items as last adjusted. The issues reported on the claim and the audit adjustments will be shown in Column B. The tax overpayment in Column C of the Auditor's Report reflects the allowable portion of the claim. The Auditor's Report is the processing document. The taxpayer's claim will not be processed because the auditor determined that the taxpayer is entitled to a lesser refund. Attach the Auditor's Report to the front of the amended return and write at the top "*For Processing Purposes – Claim Reduced".*

- **If the taxpayer agrees with the partial denial**, the auditor will prepare an EDA-153 for the taxpayer's signature. The EDA-153 will show the original amount of refund claimed, the amount of refund disallowed and the amount of refund allowed. Note: It is preferred that the taxpayer agrees with the partial denial of the claim rather than have the taxpayer withdraw the unallowable portion.

  Example: Taxpayer filed an amended return on 9/27/2007 to report a finalized RAR for the 2003 calendar year, claiming a refund of $100,000. The issues on the claim were allowable, but the auditor made adjustments that established additional tax of $25,000. The EDA-153 will show $100,000 as the amount of refund claimed, $25,000 as amount of refund disallowed and $75,000 as amount of refund allowed.

- **If the taxpayer disagrees with the partial denial of the claim**, the auditor will prepare a Notice of Proposed Claim Denial (EDA-125-I) to apprise the taxpayer of ICB rights, which the taxpayer can then exercise or await the formal Notice of Claim Denial (NOCD). For information on the ICB forms and procedures, refer to Chapter 20 Income Tax Audit Procedure.

- **If the claim is partially denied**, the Auditor's Report will reflect the allowable portion of the claim for refund. Column A of the Auditor's Report will start with GenTax line items as last adjusted, and the allowable adjustments will be shown in Column B. **If the taxpayer agrees with the partial denial**, the auditor will prepare EDA-153 for the taxpayer's signature. Note: It is preferred that the taxpayer agrees with the partial denial of the claim rather than have the taxpayer withdraw the unallowable portion.

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- **If the claim for refund is denied in full,** no Auditor's Report is required. **If agreed**, the taxpayer may formally withdraw the claim in writing that specifically identifies the claim's tax year, dollar amount and the date it was filed. Alternatively, the auditor could prepare EDA-153 for the taxpayer's signature.

- **If the taxpayer disagrees with the claim denial**, the auditor will prepare a Notice of Proposed Claim Denial (EDA-125) to apprise the taxpayer of ICB rights, which the taxpayer may then choose to exercise or file a written protest after the formal Notice of Claim Denial is issued. For information on the ICB forms and procedures, refer to Chapter 20 Income Tax Audit Procedure.

If an additional liability (that exceeds the allowable claim amount) is established for the same tax year, the auditor will issue Notice of Proposed Tax Liability and Claim Denial (Form EDA-124) to apprise the taxpayer of ICB rights if the audit findings are unagreed. **If the taxpayer agrees**, the auditor will prepare an EDA-153.

If the federal changes and/or the tax liability were overstated on the amended return, a couple of options exist. The auditor, however, must be cognizant of the statute of limitations for filing a claim for refund. If the statute has not expired and the date of overpayment will not be impacted, the taxpayer may withdraw the initial amended return in writing and file a revised claim. If the statute has not expired but the withdrawal will change the date of overpayment, obtain a subsequent amended return from the taxpayer (beginning with Column C of the first amended return) showing only the difference between the amounts previously reported and the corrected amounts in Column B. Or, you can prepare an Auditor's Report showing the proper corrections and the change in tax liability on Form IL-870. If the statute has lapsed, the out of statute overpayment can only be used to offset an additional liability in the same tax year.

C. Amended Returns Reporting an Underpayment

Amended returns self-assessing additional tax

The amount of tax due could be correct but the amended return is not properly completed. If the period does not have an unagreed audit pending in Administrative Hearings, Tax Tribunal or Circuit Court, the auditor should prepare an Auditor's Report using the as filed figures from GenTax for Column A in order to determine the correct tax due. The change as reported by the taxpayer will go in Column B with the corrected figures in Column C.

The procedure to follow in processing the amended return will be contingent on the outcome:

a. Correct Tax Self Assessed

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Liability fully paid – If the correct tax is self-assessed and the tax, any applicable penalty and interest is fully paid, the amended return can be processed when the audit is completed in the normal manner.

Partial Payment or no payment received – If the correct tax is self-assessed and a partial payment or no payment is received, a Notice and Demand for the unpaid tax, penalty and interest must be issued within 3 years of the amended return received date. Refer to Notice and Demand Procedure section.

b. Incorrect Tax Self Assessed – More Tax Due than Self-Assessed

Reported RAR Change – A Notice of Deficiency must be issued for the additional tax due within 2 years of the amended return received date and the amount of the proposed assessment must be limited to the amount resulting from the RAR change (IITA § 905(a)). The period for assessing the additional tax due as a result of the RAR change can be extended by a waiver. However, a Notice and Demand must be issued within 3 years of the received date for the self-assessed tax, penalty and interest (IITA § 902). Refer to Notice and Demand Procedure section.

If amended returns are received reporting RARs for original returns which are out of statute and have not been audited, the auditor may correct the original return before applying the RAR change. A notice of deficiency can only be issued for the portion of the liability resulting from the RAR change. However, the liability resulting from the correction of the return can be offset by any overpayments, credit or loss carryovers.

Other Changes – A Notice and Demand must be issued for the additional tax due resulting from a mathematical error (IITA § 1501(a)(12)) within 3 years of the amended return received date (IITA § 903). The Notice and Demand for the penalty and interest must also be issued within three years of the received date. Refer to Notice and Demand Procedure section.

c. Incorrect Tax Self-Assessed – Less tax due than self-assessed

Incorrect Liability Fully Paid – If the taxpayer paid the incorrect liability in full and is overpaid after the amended return is corrected, the amount overpaid can be applied to the audit liability, if any, or refunded to the taxpayer after the audit is processed. An IL-870 must be prepared detailing the amount overpaid and signed by the taxpayer.

Partially paid or No Payment received – A Notice and Demand must be issued for the correct additional liability due within 3 years of the received date of the amended return. Refer to Notice and Demand Procedure section.

D. Amended Returns Reporting an Overpayment (Claims)

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Definition of Claim

A claim is a notice to the Department, in writing, in a form prescribed by regulation, stating the specific grounds on which it is founded, requesting reimbursement or credit of all or a portion of taxes paid in prior years because of a mistake, correction or a credit or loss that can decrease an earlier year's tax liability.
http://www.businessdictionary.com/definition/claim-for-refund.html

A timely filed claim can be reduced or totally disallowed at any time and for any reason even if the statute has subsequently expired. The Department has the authority to examine any item of income, modification, allocation or apportionment (including unitary filing and group composition), whether first reported on a claim or on the original return, to determine the return's accuracy. The objective is to reach the correct amount of tax due. Any redetermination of these items may be used to reduce the overpayment requested by the taxpayer. This position is based on the decision in the case of Lewis v. Reynolds, 284 U.S. 281, 52 S.Ct. 145 (1932). This same court case also permits the taxpayer to reduce or eliminate any liability that may be established.

When an audit involves the examination of a claim which has been filed by the taxpayer, the claim will either be:

- Approved (allowed in full),
- Partially denied,
- Fully denied, or
- the taxpayer can sign a letter withdrawing the claim.

In any of these cases, an additional liability may be proposed.

If the overpayment is correct as claimed on the amended return, the audit can be completed in a normal manner. The overpayment can be reduced by other issues in the same year, offset against liabilities in other years in the audit period or refunded.

If the claim for refund is reduced for any reason, the taxpayer must partially or completely withdraw the claim contingent on the circumstances or a notice of claim denial must be issued.

Three events can result in not allowing a claim as filed:

- Claim is not timely filed
- All or some of the adjustments on the claim are not allowable
- Column A of the claim does not match figures on GenTax

An original return does not constitute a refund claim under IITA § 909(d) and (e).
A claim for refund of an overpayment may be filed only if a return for the taxable year for which a refund is claimed has been filed.

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If a return showing a tax liability for the tax year has been filed and the tax paid, and the due date prescribed for filing the return has not passed, any refund claim filed before that date is made by filing an amended return marked "CORRECTED" showing the overpayment to be refunded. (IAC § 100.9400(f)(3))

Separate claims must be filed for each taxable year for which an income tax overpayment was made.

A premature or incomplete claim is not considered a refund claim. The Department will notify the taxpayer as soon as practicable of a premature, incomplete or defective claim so that a proper claim can be timely filed (if possible).

1. Received Date of Amended Return

The date a claim is received is important for statute of limitations and interest purposes.

If Audit Planning receives amended returns through the mail, the received date will be the postmark date on the envelope, if legible. REF: 5 ILCS 70/1.25. If not legible, the date that the claim was received in the Department's mail room shall be prima facie evidence that the postmark date on the claim was 10 days prior to that date. (IAC § 100.9400(f)(2))

If a taxpayer "files" a claim with an auditor, the auditor should indicate the date received on the amended return and make a notation of the claim receipt and date on the EDC-5.

2. Department Responsibility

The Department must approve or deny (partially or completely) any claims received before the end of six months from the date the claim was filed. If the Department fails to approve or deny the claim within that time period, the taxpayer can file a written protest.

3. Limitations on Claims for Refund

Claims for refund must be filed not later than three years after the date the return was filed, or one year after the tax was paid, whichever is later.

a) Amount of Credit or Refund

(1) When a claim is filed within the 3-year period

Credit or refund shall not exceed the portion of the tax paid within the 3 year period, plus any extension of time for filing the return, immediately preceding the filing of the claim.

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(2) When claim is not filed within the 3-year period

Credit or refund shall not exceed the portion of the tax paid during the one year immediately preceding the filing of the claim.

(3) When claim relates to net loss carryback

IITA § 911(g) states that the limitations set on the amount of refund allowable under IITA § 911(d) will not apply in instances of a net loss carryback. This means that the amount of the refund allowable under IITA § 911(g) will not be limited to the amount of tax paid in the 3-year (plus period for extension of time to file return) or 1-year period immediately preceding the filing of the return.

4. Claim for Refund Based on Net Loss

IITA § 911(h)

Any amended returns received reporting a refund (overpayment), are to be handled as detailed in Initial Review and Perfecting of Amended Returns and also examined for changes to the Illinois net loss deduction. If an Illinois net loss deduction is created or has been increased the following procedures apply.

The loss year IL-1120 or IL-1120-X reporting the loss must be filed before an IL-1120-X for the carryforward year can be filed. A completed Illinois Schedule NLD or UB/NLD must be attached to the IL-1120-X.

a) Loss Years Ending on or After December 31, 2002

For audits that include Illinois net loss carryovers from tax years ending on or after December 31, 2002, the Illinois net losses can be adjusted without regard to IITA § 911(h). For loss years ending on or after December 31, 2002, including years that are closed to statute, Illinois net losses on GenTax can be adjusted for the following reasons:

- Federal taxable income changes
- Nonbusiness income and modification changes
- Apportionment changes
- Unitary group member changes (if the loss year is within statute)

Taxpayers can increase or decrease their loss year return at any time if the loss is being carried forward, but if the carryforward year is expired, then in order for the statute to reopen on the carry year for refund, the increased INL has to be from an RAR that was reported under IITA § 506(b) on an IL-1120-X within 2 years and 120 days of the RAR finalization date. If the carry year is expired, the INL can still be carried to offset a liability, including an audit liability in the carry year, but no refund will be allowed.

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Example: For 2006 the taxpayer timely files an IL-1120 showing an INL of $10,000 and carries that loss to its 2007 IL-1120 to offset Illinois net income of $20,000. At the time the audit is started the 2006 return is out of statute but the 2007 return is in statute. The auditor examines both years and determines that the taxpayer actually should have reported an INL of $15,000 for 2006 and Illinois net income of $30,000 for 2007. Nothing in the statute prevents the auditor from preparing an IL-1120-X for 2006 and increasing the amount of the INL, and then carrying that loss to another year. Even if the taxpayer does not agree to the audit, the increased $5,000 in INL for 2006 will still be carried forward and used as an offset against the 2007 NOD.

Example: In June of 2011 an audit is started on ABC Corp for calendar years ending 2007 and 2008. The taxpayer was not previously audited. GenTax shows that for 2008 the taxpayer carried over an Illinois net loss in the amount of $8,000. After reviewing the taxpayer's filing history, the auditor discovers that 2005, 2006 and 2007 are non-filed although GenTax shows that $3,000 in estimated payments had been made for both 2006 and 2007. There is no extension for any of these years, so the general 3-year limitations period for refund claims had expired for 2005 and 2006 before the audit commenced and the limitations period for 2007 will expire on October 15, 2011 unless an extension agreement is executed. The auditor determines the following amounts for 2005 through 2008:

ABC CORP				
	Non-Filed	**Non-Filed**	**Non-Filed**	**Per GenTax**
Description	2005	2006	2007	2008
Federal taxable Income	-200,000	120,000	60,000	300,000
Net modifications	20,000	-30,000	10,000	-20,000
Base Income	-180,000	90,000	70,000	280,000
IL Factor	40.0%	40.0%	40.0%	40.0%
Net Income	(72,000)	36,000	28,000	112,000
INL carryover to 2006	36,000	(36,000)		
INL carryover to 2007	28,000		(28,000)	
INL carryover to 2008	8,000			(8,000)
Subject to Tax	0	0	0	104,000
7.3% tax	0	0	0	7,592
Estimated payments	0	3,000	3,000	5,000
Other payments	0	0	0	2,592
Total Payments	0	3,000	3,000	7,592

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Pending Refund	0	(3,000)	(3,000)	0

- The auditor will prepare an original IL-1120 for 2005, 2006 and 2007 showing the above figures.
- The 2005 INL must be carried to 2006, 2007 and 2008 and will offset any balance due in the carry years.
- No refund of the estimated payments will be permitted for 2006 or for 2007 unless an extension agreement for 2007 is executed prior to October 15, 2011.
- The auditor will indicate on the IL-1120 for 2006 and possibly 2007 that the refund of $3,000 for each year is out of statute.
- For 2008 the taxpayer gets only $8,000 of the 2005 INL, because the remaining amount must be carried to 2006 and 2007 even if no refund can be allowed.

  Note: If there is a future underpayment from an RAR in 2006 and 2007, the $3,000 in estimated payments may be used to offset any additional liability for those years.

b) Loss Years Ending Prior to December 31, 2002

On and after August 23, 2002, no claim for refund shall be allowed to the extent the refund is the result of an amount of net loss incurred in any taxable year ending prior to December 31, 2002 under IITA § 207:

- that was not reported to the Department within 3 years of the due date (including extensions) of the return for the loss year on either the original return filed by the taxpayer or on amended return, or

- to the extent that the refund is the result of an amount of net loss incurred in any taxable year under IITA § 207 for which no return was filed within 3 years of the due date (including extensions) of the return for the loss year.

If the original return is filed more than three years after the extended due date, the INL would still be carried and can offset a balance due in the carry year or to offset an audit or federal change increase in net income, but not to generate a refund in the carry year.

c) Non-Filed Loss Year Returns

IITA § 911(h) requires that taxpayers report net losses to the Department within three years of the extended due date for the loss year return. If no original loss return is timely filed, the taxpayer cannot claim a refund in a carry year for any claims filed on or after August 23, 2002 based on applying the unreported loss.

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Even though the loss year is past statute, an original return must still be secured to establish the past-statute filing on the system. The INL will be properly carried forward or back, but no refund of tax payments will be allowed in the carry year.

Example 1:

	~~	**As Filed**	~~~~~~	**As Filed**	~~~~~~
	2001	2002	2003	2004	2005
	Not Filed	Filed	Filed	Filed	Filed
IL net income/loss	(1,000,000)	(2,000,000)	500,000	1,300,000	800,000
2002 to 2003		500,000	(500,000)		
2002 to 2004		1,300,000		(1,300,000)	
2002 to 2005		200,000			(200,000)
Balances	(1,000,000)	0	0	0	600,000
Original tax paid at 7.3%					$43,800
	~~	**Per Audit**	~~~~~~	**Per Audit**	~~~~~~
	2001	2002	2003	2004	2005
	IL-1120	Filed	Filed	Filed	Filed
IL net income/loss	(1,000,000)	(2,000,000)	500,000	1,300,000	800,000
2001 to 2003	500,000		(500,000)		
2001 to 2004	500,000			(500,000)	
2002 to 2004		800,000		(800,000)	
2002 to 2005		800,000			(800,000)
Balances	0	(400,000)	0	0	0
Tax Overpayment					($43,800)

For 2001 the taxpayer failed to file its original IL-1120, and the year is now more than three years past the extended due date. On the original returns, as filed, the taxpayer carried forward the 2002 INL which is all used in 2005 resulting in tax paid in 2005 of $43,800.

The auditor prepares an original 2001 IL-1120, which the taxpayer signs, but it is past statute. The auditor will carry the 2001 loss to 2004, but the increased 2002 loss carryover to 2005 results in a refund in 2005. Although the 2005 refund is actually due to losses carried over from 2002, it is still the result of the increased loss being carried over from 2001 which is not subject to refund.

The auditor will include the $43,800 overpayment on the 2005 IL-1120-X, but will note in the comments section that the amount is out of statute for refund. An

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IL-1120-X is used because the EDA-125 and IL-870 are generally only used for an NOD or refund. Since there is no refund, the IL-1120-X for 2005 does not require taxpayer signature.

If the auditor is adjusting a specific year for an out-of-statute adjustment, that year must also be included in the GenTax audit period. If the taxpayer fails to sign the IL-1120 for 2001, the auditor should still carry the 2001 loss.

Example 2: The auditor is assigned an audit on 11/01/2004 for the tax years 12/2001 – 12/2002 with the following information on the original returns:

Tax Years	**12/31/2000**	**12/31/2001**	**12/31/2002**
Statute Date	Non-Filer	10/15/2005	10/15/2006
Original Returns:			
Income/Loss	0	250,000	60,000
INL c/f 12/00 to 01	0	(30,000)	
Net Income(loss)	0	220,000	60,000
As Audited:			
Income/Loss	(30,000)	250,000	60,000
INL c/f	30,000	(30,000)	
Balance	0	220,000	60,000

- The taxpayer did not file the 12/2000 return which had a loss of ($30,000);
- The 12/2000 INLD was claimed on the original 12/2001 return;
- Per IITA § 911(h), the auditor must secure the 12/2000 return prior to three years from the extended due date (10/15/2004), in order for the taxpayer to be able to claim a refund on the 12/31/2001 return;
- The INL for 12/2000 will still be carried to 12/2001, but no refund will be allowed for any estimated payments made in 12/2001. The 2001 loss is still carried if the taxpayer will not sign the 2001 IL-1120.

d) RAR Increase to a Loss

Example:

- For 12/31/1999, the taxpayer had income and it was the first year of operations;
- The taxpayer has a loss on the 12/2000 original return;
- Both original returns were filed by the extended due date;
- The 12/2000 INL was carried back to the 12/1999 return;

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- On 12/15/2004, the IRS completes an RAR on 12/2000 increasing their loss by ($50,000); and
- The RAR holds open the IITA § 911(h) requirement to adjust the loss year, allowing the taxpayer to file an amended return for the loss year.

Tax Years	12/31/1999	12/31/2000
Statute Date	10/15/2003	10/15/2004
Original Return		
Income/Loss	300,000	(100,000)
12/00 INL c/b to 12/99	(100,000)	100,000
	200,000	0
RAR change 12/15/2004		(50,000)

- IITA § 911(h) does not prohibit the RAR change to 12/2000 since the original return reporting the loss was filed within the required 3 years from the extended due date.

If the normal statute on the carryback year is expired, IITA § 911(g) allows the taxpayer to carry back the additional $50,000 to the 12/1999 return for a refund as long as the amended return is filed within the time period allowed under IITA § 506(b), which is 2 years and 120 days from the federal finalization date.

e) Misapplied Loss Carryforward

- A taxpayer has carried losses into the 12/2000 tax-year from two different tax periods: 12/1998 and 12/1999.
- The auditor has a waiver on the 12/2000 return to hold open the statute;
- The auditor agrees with the losses as filed for both years;
- The taxpayer has misapplied the loss for 12/1998 by not checking the box to forgo the carryback period.

Tax Years	12/31/1996	12/31/1997	12/31/1998	12/31/1999	12/31/2000
Original IL Inc	100,000	50,000	(150,000)	(50,000)	400,000
98 INL c/f 00			150,000		(150,000)
99 INL c/f 00				50,000	(50,000)
Inc/(loss) Remaining	0	0	0	0	200,000

- The 12/1998 loss should have gone back to offset income on the taxpayer's 12/1996 and 12/1997 returns as follows:

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Tax Years	12/31/1996	12/31/1997	12/31/1998	12/31/1999	12/31/2000
Original IL Inc	100,000	50,000	(150,000)	(50,000)	400,000
98 INL c/b 96	(100,000)		100,000		
98 INL c/b 97		(50,000)	50,000		
99 INL c/f 00				50,000	(50,000)
Inc/(loss) Remaining	0	0	0	0	350,000

In this example, no changes were made to the loss years. Therefore, IITA § 911(h) does not apply. Since the 12/2000 return is still in statute by waiver, the auditor may correct the 12/2000 return to remove the 12/1998 loss and allow only the carry forward from 12/1999. The statute will not be opened to allow the taxpayer a refund for carrying the loss back to 12/1996. However, EDA-25's should be prepared to show the application of the 12/1998 loss to 12/1996 and 12/1997. The taxpayer is not entitled to a refund for 12/1996 and 12/1997 because they are out of statute.

f) Taxpayer files Amended Return past 911(h) period

- The taxpayer timely filed an original return for 12/1995 reflecting a loss and an original 12/1996 return reflecting income with a loss carryforward from 12/1995.
- On 12/5/1999 (past statute), the taxpayer filed an amended return for 12/1995 to increase the loss by $60,000 because a subtraction modification was omitted.
- On 1/20/2003, a federal audit was completed on the 12/1996 return. The taxpayer reported the federal change on an amended return dated 2/10/2003 (within statute).

Tax Years	12/31/1995	12/31/1996
Statute Date	10/15/1999	10/15/2000
Original Return		
Income/Loss	(10,000)	20,000
12/95 INL to 12/96	10,000	(10,000)
Sub Total	0	10,000
Non RAR Il-1120-X	(60,000)	
RAR Change		30,000
Remaining Income(Loss)	(60,000)	40,000

- Auditor should allow the carry forward of $40,000 of the 12/1995 INL to 12/1996 (the original $10,000 plus $30,000 from the RAR change),
- The carry forward can only offset the balance due from the RAR.

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  - Since 1995 is past statute and the adjustment is from a non-RAR, the taxpayer cannot carry the increase INL forward for a refund in the carry year, even if the carry year is within statute.
- The taxpayer did not report the 12/1995 non-RAR changes to the loss year by filing an amended return within the required 3 years from the extended due date per IITA § 911(h).
- When carrying losses, GenTax cannot keep track of the portion of the overpayments that are nonrefundable; therefore, the Auditor's Report will have to indicate the portion of the refund that is non-refundable under Section 911(h).

Refer to the sections on Claim Allowed in Full or Claim Denials for procedures on issuing the documents required for a specific audit situation.

5. Deactivating Credits

If an original return is timely filed for a tax year and the taxpayer subsequently submits an amended return that is past statute, GenTax views the amended return as timely filed. If the amended return is reporting an overpayment, GenTax will automatically allow the refund to be issued (erroneously). In these situations, the auditor will notify Audit Review/Perfection, via a comment in the Auditor's Report, to deactivate the credit. Refer to Chapter 20 Income Tax Audit Procedure, Specific Processing Notes.

6. Abusive Tax Avoidance Transactions (ATAT)

In cases where an individual paid on a tax shelter and has now filed a claim to get a refund from the original payment, no refunds are allowed when there has not been a final federal change at the entity (IL-1065, IL-1120-ST) level. The entity must have filed an amended return based on the federal change to impact the individuals. The theory of equitable recoupment does not apply in these matters because the individuals come in with "unclean hands" when it relates to a tax shelter.

7. Refund of Overpayment of Interest

Amended returns can also be used to claim a refund where an excessive amount of interest has been charged.

The claim must be filed within the 60-day period for filing a protest, or within the three years after the return was filed or one year after the tax was paid, whichever is later.

8. Estimated Tax

Effective January 1, 2015, overpayments on Forms IL-990-T-X, IL-1120-X, IL-1065-X, IL-1120-ST-X, IL-1023-C-X and IL-1040-X can be credited against estimated tax (PA 098-0925).

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The credit will be applied to the tax year for which estimated payments are **currently due** as of the date the amended return is filed, unless an election is made to apply the credit to a different tax year.

The overpayment shown on an amended return filed after the extended due date of the original return will be considered paid on the date the amended return is filed.

> Example 1: Corporate taxpayer files an amended return for TY 2015 on 12/1/16 requesting the overpayment of $500 be applied against estimated tax. The credit is considered paid on 12/1/16, because the amended return was filed after the extended due date of the 2015 calendar-year original return.

Overpayments from a Form IL-990-T-X, IL-1120-X, IL-1065-X, IL-1120-ST-X and IL-1023-C-X filed before January 1, 2015 cannot be credited to the following year's estimated tax, unless the amended return is filed before the extended due date of the original return.

Overpayments from Form IL-1040-X filed before January 1, 2015 cannot be credited to the following year's estimated tax.

9. Composite Returns

a) For Tax Years Ending on or After December 31, 2014

The IL-1023-C-X will be retired for tax years ending on or after December 31, 2014. Amounts previously reported on this form will be reported on Form IL-1120-ST or IL-1065.

b) For Tax Years Ending on or After December 31, 2007 and Before December 31, 2014

This section pertains to the IL-1023-C-X Amended Composite Income and Replacement Tax Return, since claims for refunds for payments made that were reported (or should have been reported) to partners, shareholders, or beneficiaries as amounts paid on their behalf cannot be processed on the IL-1000-X Amended Pass-Through Entity Payment Income Tax Return. The partners, shareholders, or beneficiaries must claim these amounts on their own tax returns. (Ref. IAC § 100.5180)

(1) Overpayments

A partnership or subchapter S corporation may claim a refund or credit of any amount it paid on behalf of its partners or shareholders but may not claim a

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refund or credit of any amount paid to the Department by a partner or shareholder.

(2) Amounts collected more than once

If claims for refund or credit are timely filed by both a partner/shareholder *and* the authorized agent, for amounts collected more than once, any amount collected from the partner/shareholder in excess of the underpayment attributable to the partner/shareholder shall be refunded or credited to that partner/shareholder rather than to the authorized agent.

10. Erroneous Refunds

a) Electronic Filing

An overpayment of tax refunded to a taxpayer whose return was filed electronically shall be considered an erroneous refund if, after proper notice and demand by the Department, the taxpayer fails to provide a required signature document.

b) Interest Calculation

Any tax, interest or penalty that has been erroneously refunded bears interest from the date the refund is paid.

However, no interest is charged if the erroneous refund is for an amount less than $500 and is due to the Department's mistake (UPIA 3-2(e)).

11. Notice of Deficiency

Federal RAR – must be issued within two years from the date the amended return was filed (IITA § 905(e)). If the statute of limitations on the original return has already expired, the Notice of Deficiency is limited to the additional tax resulting from the federal changes.

12. Claim Allowed in Full

With the introduction of APT it is no longer necessary to issue an IL-870 Waiver of Restrictions for audits completed in APT. Throughout this chapter there are references to the issuance of the IL-870. Please remember that these references relate only to audits not completed in APT.

a) No Other Issues in Claim Year or Other Audited Years

Save amended return in "Processing Documents" folder in electronic audit file. No other processing documents are required.

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b) Additional Overpayment Established in Claim Year

Save amended return in "Processing Documents" folder in electronic audit file.

Auditor's Report prepared for additional overpayment amount. Column A figures will be from Column C of the amended return. Column B will be the additional overpayment amount. The refund from the amended return will be reflected as a pending refund on the Auditor's Report.

IL-870 issued reflecting the audit overpayment amount from the Auditor's Report. The refund from the amended return is not reflected on the IL-870.

Comments:

"The above amount reflects an increase of the claim filed on xx/xx/xx for the tax year ending xx/xx/xx in the amount of $xx,xxx. The total claim being allowed for this year is $xx,xxx."

If the statute has tolled, the out of statute overpayment can only be used to offset additional liability in the same tax year.

c) Other Liability Established in Claim Year Resulting in a Net Overpayment

Save amended return in "Processing Documents" folder in electronic audit file.

Auditor's Report prepared for liability established in audit. Column A figures will be from Column C of the amended return. Column B will be the liability established in audit. The refund from the amended return will be reflected as a pending refund on the Auditor's Report.

- Unagreed
  - EDA-122 is prepared for the liability amount.
- Agreed
  - IL-870 issued reflecting additional liability amount. The refund from the amended return is not reflected on the IL-870.

    Comments:

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"Execution of this form will allow approved claim filed for the Y/E xx/xx/xx, in the amount of $xx,xxx to be used to offset the above proposed liability which will result in a net overpayment of $xx,xxx being refunded."

d) Other Liability Established in Claim Year Resulting in a Net Underpayment

Save amended return in "Processing Documents" folder in electronic audit file.

Auditor's Report prepared for liability established in audit. Column A figures will be from Column C of the amended return. Column B will be the liability established in audit. The refund from the amended return will be reflected as a pending refund on the Auditor's Report.

- Unagreed
  - EDA-122 is prepared for the liability amount.
- Agreed
  - IL-870 issued reflecting additional liability amount. The refund from the amended return is not reflected on the IL-870.

    Comments:

    Execution of this form will allow approved claim filed for the Y/E xx/xx/xx, in the amount of $xx,xxx to be used to offset the above proposed liability and penalties (plus applicable interest) which will result in a net liability of $xx,xxx (plus applicable interest) being due.

e) Other Audit Years Also Result in Overpayments

Save amended return in "Processing Documents" folder in electronic audit file.

Auditor's Report prepared for other year's audit adjustments. Column A figures will match GenTax. Column B will reflect the audit adjustments.

IL-870 issued reflecting audit overpayment from other years. Refund from claim is not reflected on the IL-870. Since overall result on IL-870 is overpayment, no additional comments are required.

f) Other Audit Years Establish Audit Liability

Save amended return in "Processing Documents" folder in electronic audit file.

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Auditor's Report prepared for other year's audit adjustments. Column A figures will match GenTax. Column B will reflect the audit adjustments.

- Unagreed
  - EDA-122 issued for other year's additional liability
- Agreed
  - IL-870 issued reflecting each of other year's audit adjustments, including applicable penalties. Refund from claim is not reflected on the IL-870. Since approved claim is not shown on IL-870 and if taxpayer wants to offset pending refund (i.e. make a net payment):
    - If audit liability on IL-870 exceeds approved claim amount: Include comment on IL-870: "Execution of this form will allow approved claim filed for the Y/E xx/xx/xx, in the amount of $xx,xxx to be used to offset the above proposed liability and penalties which will result in a net liability of $xx,xxx (plus applicable interest) being due."
    - If approved claim amount exceeds audit liability on IL-870: Include comment on IL-870: "Execution of this form will allow approved claim filed for the Y/E xx/xx/xx, in the amount of $xx,xxx to be used to offset the above proposed liability and penalties (plus applicable interest) which will result in a net overpayment of $xx,xxx (plus applicable interest) being refunded."

g) Increase Claim in Claim Year – includes instructions if other years also audited

Save amended return in "Processing Document's" folder in electronic audit file.

Auditor's Report prepared for audit adjustments to claim year. Column A of Auditor's Report should show figures from Column C of amended return. Auditor's Report will reflect audit adjustments only. Overpayment from amended return should be shown as pending refund on Auditor's Report. (Auditor's Report(s) will also be required for other years if there are audit adjustment(s)).

- Unagreed
  - EDA-122 issued, if audit adjustments for other years result in a liability.
- Agreed

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- IL-870 issued reflecting overpayment from above Auditor's Report, as well as any overpayment or underpayment from other audit years. Refund from amended return is not reflected on the IL-870. Since approved claim is not reflected on IL-870:

  - If overall audit results are liability which is less than the claim allowed:
    Include comment on IL-870: "Execution of this form will allow approved claim filed for the Y/E xx/xx/xx, in the amount of $xx,xxx to be used to offset the above proposed liability and penalties (and applicable interest) which will result in a net overpayment of $xx,xxx (plus applicable interest) being refunded."

  - If overall audit results are liability which is more than the claim allowed:
    Include comment on IL-870: "Execution of this form will allow approved claim filed for the Y/E xx/xx/xx, in the amount of $xx,xxx to be used to offset the above proposed liability and penalties (and applicable interest) which will result in a net balance still due of $xx,xxx (plus applicable interest)."

13. Claim Denials

a) Claim Not Timely Filed

Save amended return in "Federal & IL Returns" folder indicating do not process in electronic audit file.

- Unagreed
  - EDA-125-1 issued
- Agreed
  - EDA-153 issued, or
  - Taxpayer may formally withdraw the claim in writing that specifically identifies the claim's tax year, dollar amount and the date it was filed, or
  - IL-870 issued reflecting a zero increase and zero decrease in tax liability for the tax year including the following comments:

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"The above amounts reflect a total denial of the claim filed on xx/xx/xx for the tax year ending xx/xx/xx, requesting a refund of $xx,xxx. Execution of this Form IL-870 will constitute a formal withdrawal of the claim(s)."

b) Claim Fully or Partially Denied

(1) No Additional Audit Adjustment for Claim Year

Follow same procedures as Claim Not Timely Filed.

c) Claim Partially Denied

(1) Other Audit Adjustments to Claim Year

Auditor's Report prepared to reflect allowable amended return issues only. Column A figures are from GenTax. Column B figures are allowable adjustments only. Save Auditor's Report in "Processing Documents" folder in electronic audit file as process first. Save amended return in "Federal and IL Returns" folder as DNP.

Second Auditor's Report prepared to reflect audit adjustments for claim year. Column A figures will be from Column C of first Auditor's Report. Overpayment from first Auditor's Report (if applicable) should be reflected as pending refund. Save Auditor's Report in "Processing Documents" folder in electronic audit file as process second.

- Unagreed
  - EDA-125 issued if partial denial of claim is only unagreed issue, or
  - EDA-124 issued if partial denial of claim and proposed audit liability are unagreed, or
  - EDA-122 issued if proposed audit liability is unagreed.
- Agreed
  - EDA-153 issued for denied portion of claim, and
  - IL-870 reflecting audit results for claim year from last Auditor's Report and calculate penalty on net liability, if applicable.

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(2) Additional Liability Proposed in Other Audit Year Resulting in a Net Overpayment

Auditor's Report prepared to reflect allowable amended return issues only. Column A figures are from GenTax. Column B figures are allowable adjustments only. Save Auditor's Report in "Processing Documents" folder in electronic audit file. Save amended return in "Federal and IL Returns" folder in electronic audit file as DNP. (Auditor's Reports will also be required for other years if there are audit adjustment(s)).

- Unagreed
  - EDA-125 is issued, if the partial claim denial is the only unagreed issue, or
  - EDA-124 is issued, if the partial claim denial and additional liability is unagreed.
- Agreed
  - EDA-153 issued for denied portion of claim, and
  - IL-870 reflecting the allowable portion of the claim and the additional liability amount.

    Comments:

    "The above amount for the tax year xx/xx/xx reflects a partial denial of the claim which was filed on xx/xx/xx for that year in the amount of $xx,xxx. $xx,xxx of the claim was denied. Execution of the IL-870 will constitute a formal withdrawal for the denied portion of this claim.

    Execution of this form will also allow the approved portion of the claim to be used to offset the proposed liability for xx/xx/xx which will result in a net overpayment of $xx,xxx (plus any applicable interest) being refunded."

(3) Decrease Claim in Claim Year Resulting in Either Overpayment Still Existing or Liability for Claim Year - includes instructions for other audit year results

Auditor's Report prepared using figures from GenTax in Column A. Column B will reflect the allowable portion of the claim. Save Auditor's Report in "Processing Documents" folder in electronic audit file. Save amended return in "Federal and IL Returns" folder in electronic audit file as DNP. (Auditor's Report(s) will also be required for other years if there are audit adjustment(s)).

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- Unagreed
  - EDA-124 issued:
    - If original claim is decreased and an additional liability is established in the claim year or other audit years, or
  - EDA-125 issued:
    - If the decrease in claim is the only audit adjustment and the result is a still a claim or a zero tax liability.
- Agreed
  - EDA-153 issued if the decrease in claim is the only audit adjustment and the result is still a claim or a zero tax liability.
  - IL-870 issued in conjunction with the EDA-153, if there are adjustments for other audit years that result in a tax liability. Refund from amended return is not reflected on IL-870.

    Audit tax results from Auditor's Reports(s) should be reflected on IL-870 since approved claim amount is not reflected on IL-870:

    - If overall result on IL-870 is a liability:
      Include comments on IL-870, "Execution of this form will allow approved portion of the claim filed for Y/E xx/xx/xx, in the amount of $xx,xxx to be used to offset the above proposed liability and penalties (and applicable interest)", and
    - Liability on IL-870 exceeds claim, also state: "Which will result in a net liability of $xx,xxx (plus applicable interest) being due", or
    - Claim exceeds liability on IL-870, also state: "Which will result in a net overpayment of $xx,xxx (plus applicable interest) being refunded."
  - If overall result on IL-870 is overpayment:
    - No additional comments on IL-870 are required

(4) No Additional Audit Adjustment for Claim Year or Other Years

Auditor's Report prepared using figures from GenTax in Column A. Column B will reflect the allowable portion of the claim. Save Auditor's Report in

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"Processing Documents" folder in electronic audit file. Save amended return in "Federal and IL Returns" Folder in electronic audit file as DNP.

- Unagreed
  - EDA-125 is issued
- Agreed
  - EDA-153 is issued, or
  - IL-870 issued reflecting a decrease in tax for the amount of the claim that was approved.

    The Comments section will read:

    "The above amount reflects a partial denial of the claim which was filed on xx/xx/xx for the tax year ending xx/xx/xx, in the amount of $xx,xxx. $xx,xxx of the claim was denied. Execution of this IL-870 will constitute a formal withdrawal of the denied portion of this claim.

d) Claim Fully Denied

(1) No Additional Audit Adjustments for Claim Year

Save amended return in "Federal and IL Returns" folder in electronic audit file as DNP.

(2) Additional Liability Established for Claim Year

Save amended return in "Federal and IL Returns" folder in electronic audit file as DNP.

Auditor's Report prepared using figures from GenTax in Column A. Column B will reflect additional audit adjustments.

- Unagreed
  - EDA-124 is issued
- Agreed
  - EDA-153 is issued reflecting that the taxpayer's claim has been reduced to zero, and

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- IL-870 issued reflecting an increase in tax liability for the year for which a claim was filed.

  The Comments section will read:

  "The tax liability shown above for the tax year ending xx/xx/xx reflects a total denial of the claim filed on xx/xx/xx for that tax year, in the amount of $xx,xxx. Execution of this IL-870 will constitute a formal withdrawal of this claim and an agreement to the additional liability proposed."

(3) An Additional Liability is Proposed for a Different Year

Save amended return in "Federal and IL Returns" folder in electronic audit file as DNP.

Complete Auditor's Report for additional liability issue. Column A will reflect figures from GenTax.

- Unagreed
  - Issue EDA-124

- Agreed
  - Issue EDA-153 reflecting that the taxpayer's claim has been reduced to zero, and
  - IL-870 issued to reflect the additional liability.

    Comments:

    The IL-870 reflects an increase in tax for one year and a $-0- decrease in tax for the claim year.

    The Comments section will read:

    "The above amount reflects a total denial of the claim filed on xx/xx/xx for the tax year ending xx/xx/xx, in the amount of $xx,xxx. Execution of this IL-870 will constitute a formal withdrawal of this claim and an agreement to the additional liability proposed."

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(4) Other Overpayment Allowable

If the taxpayer timely files an amended return claiming an overpayment but that overpayment is not allowable, the claim for refund would be denied. However, if in our audit of that claim, we discover another issue that results in an overpayment in the same year, that overpayment would be allowed up to the amount of the timely filed claim for refund, if the statute of limitations for filing a claim for refund has expired.

- Unagreed
  - EDA-125 issued for original claim denial
- Agreed
  - EDA-153 is issued for the amount of the overpayment that was not allowable, and
  - An amended return is prepared reflecting the new overpayment amount.

e) Notice of Claim Denial

A denial of a claim for refund becomes final 60 days after the date of issuance (150 days if the taxpayer is outside the United States) of the notice of such denial except for such amounts denied as to which the claimant has filed a protest, as provided in IITA § 909.

f) Amended return reflects additional tax due – Column A agrees with GenTax

- The amended return will be processed as is
- Save amended return in "Processing Documents" folder in electronic audit file
- Tax shown on amended return is not reflected on IL-870
- Complete an Auditor's Report for any audit adjustments:
  - Column A of Auditor's Report will reflect Column C figures from the amended return that is being processed
- Any applicable unpaid tax and any applicable penalty from the amended return must be collected
- If taxpayer did not already pay liability shown on the amended return, and since liability is not shown on IL-870:
  - The audit results in a net overpayment, then add comment to IL-870:
    - "Execution of this form will allow above overpayment to be offset by the tax and penalty (if applicable) of $xx,xxx (and applicable interest) due from the amended return filed for the Y/E xx/xx/xx."
  - The audit results in a liability, then add comment to IL-870:

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- "In addition to the above audit liability, tax and penalty (if applicable) of $xx,xxx (plus applicable interest) is also due from the amended return filed for the Y/E xx/xx/xx."

g) Amended return reflects additional tax due – Column A does not agree with GenTax

Complete Auditor's Report correcting Column A figures to agree with GenTax. Column B should reflect only the issues included on the amended return.

Save Auditor's Report in "Processing Documents" folder in electronic audit file. Save amended return in "Federal and IL Returns" folder in electronic audit file as DNP.

- If this Auditor's Report results in a higher additional tax due than shown on the original amended return:

  Only the additional amount should be reflected on the IL-870

- If this Auditor's Report results in a decrease in tax due as reported on the original amended return:

  Show this decrease on the IL-870

In both situations, complete an additional Auditor's Report for any audit adjustments. Column A of the second Auditor's Report will reflect figures from Column C of the first Auditor's Report.

If taxpayer did not pay tax shown due on the original amended return (since liability on amended return is not shown on IL-870) and:

- Audit results on IL-870 reflect a net overpayment, then add comment to IL-870:

  "Execution of this form will allow above overpayment to be offset by the tax and penalty (if applicable) of $xx,xxx (and applicable interest) due from the amended return filed for the Y/E xx/xx/xx."

- Audit results on IL-870 reflect a net underpayment, then add comment to IL-870:

  "In addition to the above liability, tax and penalty (if applicable) of $xx,xxx (plus applicable interest) is also due from the amended return filed for the Y/E xx/xx/xx."

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h) Column A of Amended Return does not match figures on GenTax

(1) Adjustments on Amended Return Allowable

Prepare Auditor's Report to make the amended return processable.

- Column A of the Auditor's Report should reflect figures on GenTax.
- Column B of the Auditor's Report should reflect the adjustments on the amended return.
- Save Auditor's Report in "Processing Documents" folder in electronic audit file. Save amended return in "Federal and IL Returns" folder in electronic audit file, if column B equals the amended return.
- If Column B does not equal the amended return, then enter the difference on an IL-870.

(2) Adjustments on Amended Return Not Allowable

Prepare Auditor's Report if some of the adjustments on the amended return are allowable.

- Show results from Auditor's Report on an IL-870.
- Complete EDA-153, if agreed.
- Save amended return in "Federal and IL Returns" folder in electronic audit file as DNP.

(3) Additional Audit Adjustments to Claim Year

- Prepare Auditor's Report starting with Column C of the above Auditor's Reports
- Show overpayment (if applicable) from above Auditor's Report as pending refund
- Save Auditor's Report above in "Processing Documents" folder in electronic audit file as process first and this Auditor's Report in "Processing Documents" folder as process second. Enter additional audit adjustment from second Auditor's Report on IL-870

E. Multiple Amended Returns Filed Reporting Underpayment and Overpayments

The taxpayer may file separate unitary amended returns or combined amended returns reporting overpayments for some members and underpayments for other members. The overpayments reported on taxpayer's separate unitary or combined amended returns may be used to offset the liability of the underpaid taxpayers by completing an Offset Statement as shown in Chapter 42 Penalty and Interest - UPIA.

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Also, a taxpayer may file several years of amended returns and report overpayments in some years and underpayments in others. The overpayments and underpayments are to be processed according to the instructions contained in Chapter 42 Penalty and Interest – UPIA, Offsets between Years.

In the above situations, any amended returns reporting underpayments must still have a notice and demand issued if not fully paid within three years of the date filed. A waiver of the statute of limitations does not extend this period. If the auditor does not have enough time left on the three-year notice and demand statute to fully complete the audit, offset the overpayments and underpayments and collect the net liability due, the underpaid amended returns must be referred to Audit Perfection for the issuance of a manual notice and demand in order to protect the statute of limitations. Refer to Notice and Demand Procedure section.

F. Processing Documents

Refer to Chapter 20 Income Tax Audit Procedure for creating audit letters and reports.

1. EDA-XX Auditor's Report

EDA-24 Individual
EDA-25 Corporate
EDA-26 Fiduciary
EDA-92 IL-1065
EDA-93 S-Corp
EDA-127 IL-1023-C (available in the CIT Standalone)

The Auditor's Report is prepared in most amended return audits. In some instances, multiple Auditor's Reports will be required. Exception would be amended returns that are correct as filed. No EDA-XX is required.

For additional information on how to prepare the EDA-XX in general and when an amended return reporting underpayments and overpayments has been filed and has not been processed refer to Chapter 20 Income Tax Audit Procedure.

2. EDA-122B & EDA-122B-APT Notice of Proposed Deficiency

Notice of Proposed Deficiency should be issued when the taxpayer has indicated lack of agreement with the audit results.

EDA-122XX is required for income tax deficiencies (amended returns with additional liability due) but is not issued when the taxpayer refuses to extend the statute of limitations, if it expires before the expiration of the 60-day period for deciding to seek ICB review.

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Issued when an amended return is filed reporting an underpayment (additional tax due) or overpayment (claim for refund) and, during audit, an additional liability is proposed.

Form ICB-1, Request for Informal Conference Board Review, is issued at the same time.

3. EDA-124I & EDA-122I-APT Notice of Proposed Tax Liability and Claim Denial

Notice of Proposed Tax Liability and Claim Denial is issued when an income tax assessment and claim denial occur in the same track and the taxpayer has indicated lack of agreement with the audit results.

EDA-124XX is required for income tax deficiencies **and** full or partial claim denials that occur within the same audit track.

EDA-124XX is not issued when the taxpayer refuses to extend the statute of limitations if it expires before the expiration of the 60-day period for deciding to seek ICB review.

Issued when an amended return is filed reporting and overpayment (claim for refund) and, during audit, the original claim is fully or partially denied and an additional liability is proposed.

Form ICB-1, Request for Informal Conference Board Review, is issued at the same time.

4. EDA-125I & EDA-125I-APT Notice of Proposed Claim Denial

Notice of Proposed Claim Denial is issued when a claim has been partially or fully denied and the taxpayer has indicated lack of agreement with the audit results.

EDA-125XX is required only for full or partial income tax claim denials.

EDA-125XX is not issued when the taxpayer refuses to extend the statute of limitations if it expires before the expiration of the 60-day period for deciding to seek ICB review.

Issued when an amended return is filed reporting an overpayment (claim for refund) and, during audit, the original claim is fully or partially denied.

Form ICB-1, Request for Informal Conference Board Review, is issued at the same time.

5. EDA-143I & EDA-143I-APT Results-IL-870 Information

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The EDA-143I is a cover letter to be used whenever an IL-870 is issued providing instructions and explaining the taxpayer's rights. The EDA-143I letter will set all system required indicators and information transactions for the correct application of penalty.

6. EDA-143CA Results – Return Approval

On May 25, 2015 a new GenTax Audit letter became available for Income Tax audits. Up until that point, Income Tax auditors had no access to a Notice of Audit Results which could be used to cover an audit which contained both original and amended returns. The new EDA-143CA allows for this. In addition, the former results letter did not contain the required language for returns filed with unpaid balances which could be subject to additional penalty. The EDA-143CA "Results - Return Approval" replaces the EDA-143CA "Results-Amd Return Approval" and EDA-143CO "Results-Original Return Approval" letters.

The EDA-143CA is a cover letter to be used when a return is accepted as filed. The EDA-143CA letter will set all system required indicators and information transactions for the correct application of penalty.

7. EDA-143RR Notice of Audit Results Acceptance of Revised Claim for Refund

The EDA-143RR is a cover letter to be used with the EDA-153. It gives directions for completion and provides an explanation of taxpayer's rights. The EDA-143RR must be provided to the taxpayer at the same time as the EDA-153. The EDA-143RR will also set all system required indicators and informational transactions for the correct application of penalty.

8. EDA-153 Acceptance of Revised Claim for Refund

a) Purpose of the EDA-153

The EDA-153 is used:

- When one or more claims filed by the taxpayer have been reduced in audit and the taxpayer agrees to the reduction
- If the claim reduction results in a tax liability
- To expedite the processing of the claim since it clarifies for Audit Perfection what claims have been filed and what reductions have been agreed to by the taxpayer.

The EDA-153 applies to claims filed by the taxpayer on the following amended returns:

- IL-1120-X, Amended Corporation Income and Replacement Tax Return
- IL-1065-X Amended Partnership Replacement Tax Return

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- IL-1120-ST-X, Amended Small Business Corporation Replacement Tax Return
- IL-1041-X, Amended Fiduciary Income and Replacement Tax Return
- IL-1023-C-X, Amended Composite Income and Replacement Tax Return
- IL-941-X, Amended Illinois Withholding Tax Return
- IL-990-T-X, Amended Exempt Organization Income and Replacement Tax Return
- IL-1040-X, Amended Individual Income Tax Return

b) When to Use the EDA-153

The EDA-153 is used when one or more claims filed by the taxpayer have been reduced during an audit, either partial or full claim denials. As long as the taxpayer signs the EDA-153, no IL-870 and EDA-125 Notice of Proposed Claim Denial is required. The Auditor's Report (i.e. EDA-25) is still required to support the claim reduction amounts on the EDA-153.

The EDA-153 is also used if the claim reduction results in a tax liability. The EDA-124 Notice of Proposed Tax Liability and Claim Denial and ICB-1 are presented to the taxpayer. If the taxpayer agrees to the tax, then the taxpayer will be provided both the EDA-153 and IL-870 for signature. The IL-870 will reflect the Column B amount on the EDA-25 and the EDA-153 will show that the taxpayer's claim has been reduced to zero.

The EDA-153 is issued when an amended return is filed reporting an overpayment (claim) and, during audit, the claim is fully or partially denied.

However, if the taxpayer does not agree to a claim reduction, execution of the IL-870 is required. The EDA-143-I, Results – IL-870 Information, should accompany the IL-870 explaining the taxpayer's options and protest rights.

c) When Not to Use the EDA-153

The EDA-153 is not used when:

- All claims have been accepted as filed
- The claim reductions are unagreed
- For any amended returns showing an underpayment
- Amended returns showing changes to an Illinois Net loss and credit carryovers that do not result in an actual reduction to the liability reported on an original or previously filed amended return
- Any claims prepared by the auditor
- Math error adjustments

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d) Timeframe for Issuing the EDA-153

The EDA-153 will not be issued if the claim is not timely filed.

The Department must approve or deny claims within 6 months from the date the claim was filed.

e) Completion of the EDA-153

Multiple claims can be listed on the same EDA-153. An EDA-153 must be prepared if at least one claim year is being reduced and the taxpayer agrees to the reduction. For any year in which the auditor is increasing the claim, that year is not shown on the EDA-153, as there is no language on the EDA-153 for claim increases.

While in the Audit View (GenTax), the EDA-153 can be accessed through the Letters sub-tab under the CRM Tab. Select the Add Tab to access the Mail Types (letters) listing.

Select the EDA-153 blue hyperlink in the *Type* column.

The Input screen (shown below) opens allowing for information entry. All figures are entered as positive amounts. There are five columns on the EDA-153.

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- Column (A) “Tax Year” (Year) is entered as xx/xx/xxxx.

- Column (B) “Date Claim Filed” (Claim Date) is the date that the Department received the claim, if mailed, or the date that the auditor received the claim if it came directly from the taxpayer.

- Column (C) “Amount of Refund Claimed” (Refund Claim) is the net refund claimed by taxpayer after applying all payments and credits. For example, on a 2010 IL-1120-X, the amount is Step 9, Line 60.

- Column (D), “Amount of Refund Disallowed” (Disallow) is the amount being disallowed. Any correction to the taxpayer’s payments and credits would be reflected in Column D.

- Column (E) “Amount of Refund Allowed” (Allow) is the correct amount of refund allowed from that amended return, and Column (D) “Amount of Refund Disallowed” is the difference between Columns (C) and (E).

Once info is entered, select the Preview Letter tab to review the letter, then select Save. The EDA-153 is required to be printed for the taxpayer’s signature. Two signature lines are provided on the EDA-153 in case of individual taxpayers.

Below is a screen print of an EDA-153 which shows the five columns referred to above.

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Illinois Department of Revenue

EDA-153 Acceptance of Revised Claim for Refund

Taxpayer name: IMA TAXPAYER CORP
DBA:
Taxpayer address: 1000 Main Street
Everywhere, IL 60000

Taxpayer ID: 00-0000000
Account ID: 00-0000000
Audit ID: A123456789
Return Type: IL1120
Audit Periods: 01/01/2010-12/31/2011

I, the above named taxpayer, have previously filed a refund claim for one or more tax years included in the above audit. I hereby agree to the revised claim for refund amount as shown in column (E).

(A) Tax Year	(B) Date Claim Filed	(C) Amount of Refund Claimed	(D) Amount of Refund Disallowed	(E) Amount of Refund Allowed
12/31/2011	3/1/2013	$100,000.00	$40,000.00	$60,000.00

Once the audit has been submitted for processing, the taxpayer's account will be adjusted to the agreed amounts. If the taxpayer does not sign the EDA-153, the auditor should mark the EDA-153 as "VOID". This will alert Audit Perfection that claim reductions have not been agreed to by the taxpayer. The auditor should also document an explanation on the EDC-5 as to why the taxpayer did not sign the EDA-153 after it was generated.

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Blank copy of the EDA-153:

Illinois Department of Revenue

EDA-153 Acceptance of Revised Claim for Refund

Taxpayer name:
DBA:
Taxpayer address:

Taxpayer ID:
Account ID:
Audit ID:
Return Type:
Audit Periods:

I, the above named taxpayer, have previously filed a refund claim for one or more tax years included in the above audit. I hereby agree to the revised claim for refund amount as shown in column (E).

(A) Tax Year	(B) Date Claim Filed	(C) Amount of Refund Claimed	(D) Amount of Refund Disallowed	(E) Amount of Refund Allowed

Sign below:
I hereby waive the requirement under statute that a notice of claim denial be sent to me for the amount of refund disallowed as shown in column (D). I understand that the filing of this waiver is irrevocable and fully resolves the above amended returns. I understand that this waiver will allow the department to process my claim for refund amount as shown in column (E).

- If you filed a joint return for the year involved, both you and your spouse must sign this waiver. If acting under a power of attorney, one may sign as agent for the other.
- If a corporate return was filed, this waiver must be signed with the corporate name followed by the signature and title of the officer(s) duly authorized to sign.
- If you are a taxpayer's attorney or agent, your actions must be specifically authorized by a power of attorney. If the power of attorney was not previously filed, it must accompany this waiver.
- If you are a person acting in a fiduciary capacity (e.g., executor, administrator, or trustee), Form IL-56, Notice of Fiduciary Relationship, must accompany this form, unless Form IL-56 was previously filed.

Corporate name

Taxpayer's signature Title Date

Taxpayer's signature Title Date

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f) Examples of EDA-153 Use

Example 1: The taxpayer filed refund claims for 2010, 2011 and 2012. The auditor determined that the claims should be as shown:

Tax Year	2010	2011	2012
Claim	Reduced	Accepted	Increased

The auditor includes only the claims for 2010 and 2011 on the EDA-153. The auditor includes 2011 on the EDA-153 because at least one year (2010) is being reduced, but 2012 is not listed because it is a claim increase which is reportable on an IL-870.

Example 2: On March 1, 2013 the taxpayer filed an IL-1120-X for calendar year 2010 requesting a tax refund of $73,000. The auditor disallows $53,000 but allows $20,000 of the claim. If the claim is processable, then the IL-1120-X will be processed first so that Column B of the IL-1120-X becomes Column A of the EDA-25. Audit adjustments that reduce the claim by $53,000 will be reflected in Column B of the EDA-25 and explained on the EDA-25. Normally, the Column B tax change would be entered on the IL-870, but since the EDA-153 replaces the IL-870, the tax change of $53,000 will be entered in Column D of the EDA-153.

The EDA-153 will show:

I, the above named taxpayer, have previously filed a refund claim for one or more tax years included in the above audit. I hereby agree to the revised claim for refund amount as shown in column (E).

(A) Tax Year	(B) Date Claim Filed	(C) Amount of Refund Claimed	(D) Amount of Refund Disallowed	(E) Amount of Refund Allowed
12/31/2010	3/1/2013	$73,000.00	$53,000.00	$20,000.00

Note: if any audit change is made to the claim and that audit change increases the tax liability as shown on the claim, then the taxpayer's claim has been "reduced" for the year, and the taxpayer should be given the EDA-153.

Example 3: The taxpayer files an IL-1120-X for 2010 claiming a refund of $10,000. The auditor determines that the Column A figure is not correct because there was a previously filed claim that the taxpayer forgot to include thereby affecting the claim amount. The auditor still enters $10,000 in Column C because that's the refund the taxpayer requested. Any errors in Column A that result in a decrease in the refund will be part of the adjustment in Column E. If the auditor increases the claim, then that change will be reported on an IL-870 and not the EDA-153.

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9. PROD-1

Effective September 2019 the PROD-1 was introduced in APT Release 21, including new features and codes.

Refer to Chapter 20 Income Tax Audit Procedure for a more detailed explanation on how to complete the PROD-1 and associated codes.

The remainder of this section will be removed during the next chapter update.

The PROD-1 should be issued in all audits.

Liability Status Codes

Amended Returns reflecting an underpayment:

Amended Returns that indicate additional tax due should be coded as:

- AP- Agreed Paid, or
- AL- Agreed Liability

The results of the audit should be coded as:

- AP – Agreed Paid,
- AL – Agreed Liability, or
- CM – Credit Memo

Amended Returns reflecting an overpayment:

Whenever an original claim (OC) exists and the auditor determines that a reduction in the claim is required, either CR (claim reduction) or WC (withdrawn notice/claim) will be used:

- OC is the original amount of the claim filed
- CR is used when the taxpayer disagrees with the reduction
- WC is used when the taxpayer agrees with the reduction

In any agreed audit, any OC (original claim) or CL (claim) amount may be used to offset a liability established during the audit. The offset amount would be coded CM (credit memo). This code is used to indicate that all or a portion of the claim allowed is being used to offset part or all of the liability due.

When an additional liability is being offset with a pending refund, code CM (credit memo) should be used.

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Note that all unprocessed claims for refund, whether received from Audit Planning, from the taxpayer, or generated in the audit should be coded on the PROD-1 as OC.

Amended returns within an audit are to be addressed whether the claim is denied, withdrawn or allowed.

Audits dealing only with claims for refund are never to be coded NL (no liability).

a) Examples

Claim Reduction (CR) – if reduction is unagreed or Withdrawn Notice/Claim (WC) if withdrawal is agreed

If an audit involves verifying a claim for refund, the amount of the original claim filed should be coded as OC (Original Claim). Whenever it is determined that a claim is to be reduced, then code CR (Claim Reduction) or code WC (Withdrawn Notice/Claim) is used to indicate the amount that the claim is **reduced by**. If the claim for refund covers more than one issue, the auditor should determine the principal issue of the claim for refund and use that liability code when posting the OC amount. The OC amount is entered as a negative number (-) and the CR or WC amount is always entered as a positive (+). The OC amount will not be reflected in the total for Part 1.

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CR: Taxpayer files a claim for refund in the amount of $10,000. This claim was the result of the taxpayer increasing the amount of the income tax investment credit claimed for the year. Per audit only $8,000 was allowable. Therefore the claim was reduced by $2,000. The audit was unagreed to on this issue by the taxpayer.

Part 1: Additional Liability by Period

Area:	***290 IT Credit Change IT Investment***	Code:	***OC***	Amount:	***$***	***(10,000)***
Area:	***290 IT Credit Change IT Investment***	Code:	***CR***	Amount:	***$***	***2,000***
				Total Additional Liability:	**$**	**2,000**

Part 2: Status of Additional Liability

Code:	***OC***	Amount:	***$***	***(10,000)***
Code:	***CR***	Amount:	***$***	***2,000***
		Total Additional Liability:	**$**	**2,000**

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CR: Taxpayer files a claim for refund in the amount of $10,000. This claim was the result of the taxpayer increasing the amount of the income tax investment credit claimed for the year. Per audit this credit amount increase would not be allowed. The audit was unagreed to on this issue by the taxpayer.

Part 1: Additional Liability by Period

Area:	290 IT Credit Change IT Investment	Code:	OC	Amount:	$ (10,000)
Area:	290 IT Credit Change IT Investment	Code:	CR	Amount:	$ 10,000
			Total Additional Liability:		$ 10,000

Part 2: Status of Additional Liability

Code:	OC	Amount:	$ (10,000)
Code:	CR	Amount:	$ 10,000
	Total Additional Liability:		$ 10,000

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WC: Taxpayer files a claim for refund in the amount of $10,000. This claim was the result of the taxpayer increasing the amount of the income tax investment credit claimed for the year. Per audit this credit amount increase would not be allowed. The taxpayer agrees to withdraw the claim and agrees to the audit findings.

Part 1: Additional Liability by Period

Area:	***290 IT Credit Change IT Investment***	Code:	***OC***	Amount:	***$ (10,000)***
Area:	***290 IT Credit Change IT Investment***	Code:	***WC***	Amount:	***$ 10,000***
			Total Additional Liability:		**$ 10,000**

Part 2: Status of Additional Liability

Code:	***OC***	Amount:	***$ (10,000)***
Code:	***WC***	Amount:	***$ 10,000***
	Total Additional Liability:		**$ 10,000**

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WC: Taxpayer files a claim for refund in the amount of $10,000. This claim was the result of the taxpayer increasing the amount of the income tax investment credit claimed for the year. Per audit only $8,000 was allowable. Therefore, the claim was reduced by $2,000 which the taxpayer agreed to. An offset of $5,000 was agreed to by the taxpayer when the audit disallowed the Non-business income amount. The taxpayer requested the remaining $3,000 as a refund.

Part 1: Additional Liability by Period

Area:	***290 IT Credit Change IT Investment***	Code:	***OC***	Amount:	***$***	***(10,000)***
Area:	***290 IT Credit Change IT Investment***	Code:	***WC***	Amount:	***$***	***2,000***
Area:	***229 Non-Bus Inc. Disallowed***	Code:	***CM***	Amount:	***$***	***5,000***
			Total Additional Liability:		**$**	**7,000**

Part 2: Status of Additional Liability

Code:	***OC***	Amount:	***$***	***(10,000)***
Code:	***WC***	Amount:	***$***	***2,000***
Code:	***CM***	Amount:	***$***	***5,000***
	Total Additional Liability:		**$**	**7,000**

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WC: Taxpayer files a claim for refund in the amount of $10,000. This claim was the result of the taxpayer increasing the amount of the income tax investment credit claimed for the year. Per audit this credit amount increase would not be allowed. The taxpayer agrees to withdraw the claim. It was also determined in the audit that the R & D credit taken by the taxpayer was overstated. The additional liability was $5,000 which the taxpayer agreed to and paid with a check.

Part 1: Additional Liability by Period

Area:	***290 IT Credit Change IT Investment***	Code:	***OC***	Amount:	***$***	***(10,000)***
Area:	***290 IT Credit Change IT Investment***	Code:	***WC***	Amount:	***$***	***10,000***
Area:	***280 IT Credit Change R&D***	Code:	***AP***	Amount:	***$***	***5,000***
				Total Additional Liability:	**$**	**15,000**

Part 2: Status of Additional Liability

Code:	***OC***	Amount:	***$***	***(10,000)***
Code:	***WC***	Amount:	***$***	***10,000***
Code:	***AP***	Amount:	***$***	***5,000***
		Total Additional Liability:	**$**	**15,000**

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WC: Taxpayer files a claim for refund in the amount of $10,000. This claim was the result of the taxpayer increasing the amount of the income tax investment credit claimed for the year. Per audit only $8,000 was allowable. Therefore, the claim was reduced by $2,000 which the taxpayer agreed to. An offset of $8,000 was agreed to by the taxpayer when the audit disallowed the Non-business income amount. A Federal RAR change creates a $1,000 claim, but this claim is offset when the auditor determines that the R & D credit taken by the taxpayer was overstated.

Part 1: Additional Liability by Period

Area:	290 IT Credit Change IT Investment	Code:	OC	Amount:	$	(10,000)
Area:	290 IT Credit Change IT Investment	Code:	WC	Amount:	$	2,000
Area:	229 Non-Bus Inc. Disallowed	Code:	CM	Amount:	$	8,000
Area:	206 Federal RAR Change	Code:	CL	Amount:	$	(1,000)
Area:	280 IT Credit Change R&D	Code:	CM	Amount:	$	1,000
				Total Additional Liability:	$	10,000.00

Part 2: Status of Additional Liability

Code:	OC	Amount:	$	(10,000)
Code:	WC	Amount:	$	2,000
Code:	CM	Amount:	$	9,000
Code:	CL	Amount:	$	(1,000)
		Total Additional Liability:	$	10,000.00

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Claim Increase (CL)

If an audit includes changes due to an original claim for refund filed by the taxpayer, those changes are identified by the liability code OC (Original Claim). Whenever a claim for refund is the result of an audit, then CL (Claim Established) is used to indicate the amount of the claim. The OC amount is entered as a negative number (-) and the CL amount is entered as a negative (-) also.

Taxpayer files a claim for refund in the amount of $10,000. Per audit this amount was allowed, with an additional overpayment of $5,000 established in audit. Therefore, the taxpayer is entitled to the $15,000 overpayment. (For production purposes only, the CL increased claim is counted).

Part 1: Additional Liability by Period

Area:	***290 IT Credit Change IT Investment***	Code:	***OC***	Amount:	***$ (10,000)***
Area:	***293 Other Adjustments***	Code:	***CL***	Amount:	***$ (5,000)***
			Total Additional Liability:		**$ (5,000)**

Part 2: Status of Additional Liability

Code:	***OC***	Amount:	***$ (10,000)***
Code:	***CL***	Amount:	***$ (5,000)***
	Total Additional Liability:		**$ (5,000)**

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Claim Accepted as Filed

In certain audit situations, there may be zero tax impact per the audit findings, so the claim will be accepted as filed.

Taxpayer files amended returns for 2005, 2006, and 2007. The 2005 return shows a $20,000 refund, the 2006 returns shows and $8,000 refund, and the 2007 return shows a balance due of $6,000 for which the taxpayer has made a payment that has been posted. The only change that was made on these returns was to taxable income. Per the audit both the balance due and the claim amounts are correct.

Part 1: Additional Liability by Period

Area:	205 Tax Income Under / Overstated	Code:	OC	Amount:	$ (28,000)
Area:	205 Tax Income Under / Overstated	Code:	AP	Amount:	$ 6,000
				Total Additional Liability:	$ 6,000

Part 2: Status of Additional Liability

Code:	OC	Amount:	$ (28,000)
Code:	AP	Amount:	$ 6,000
		Total Additional Liability:	$ 6,000

10. IL-870 Waiver of Restrictions

Instructions for the preparation of an IL-870 refer to audits not part of APT, as well as audits involving issues prior to tax year 2000. It is no longer necessary to issue an IL-870 for audits being completed in APT. The IL-870M will remain in GenTax for those audits not yet part of the APT program. For audits prepared in APT refer to the New IL-870 Procedure in the APT Reference Guide.

The Waiver of Restrictions should be prepared in most audit situations. It is not required when the amended return is correct as filed or when a claim is withdrawn. An IL-870 is also not required when there is a signed EDA-153.

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It is important to remember that the IL-870 is not superseding the claim which is originally filed, unless the taxpayer formally withdraws the original claim. Generally, the IL-870 is proposing an adjustment to a previously filed claim. This is an important distinction since, at times, the "date of overpayment" is the date the claim was filed and, at other times, contingent on the date the claim was filed, the "date of overpayment" may be the end of the loss year.

The manner in which the IL-870 would be completed, and the types of statements which should appear in the Comments section in various situations, can be found in the Claim Allowed in Full and Claims Denial sections.

For more information regarding the IL-870 and the procedures for processing audits with agreed and/or paid liabilities, refer to Chapter 20 Income Tax Audit Procedure.

11. Withdrawal Letter

A taxpayer-prepared withdrawal letter is required when a claim is denied in full and the taxpayer agrees. The letter can be prepared in lieu of the EDA-153 or the IL-870.

12. Additional Amended Return

An additional amended return would normally be filed when an overpayment is greater than that claimed on the original amended return.

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Tax Shelters

Issued 11/2017

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I. PURPOSE

This chapter contains a discussion of tax shelters, the penalties and policies the Department and Audit pursue regarding both taxpayers and promoters, and the Voluntary Compliance Program (VCP) that the Department conducted from October 15, 2004 through January 31, 2005.

II. REFERENCES

- P.A. 93-840
- IITA §§ 501(b), 905(b)(2), 1001(b), 1005(b) & (c), 1007, and 1008
- IAC §§ 100.5060, 100.5070, 100.5080, & 100.9900
- IDOR Informational Bulletins FY 2005-06 & FY 2005-17
- IRC §§ 6011, 6111, 6112, 6662A, 6700, 6707, 6707A, & 6708
- 26 CFR § 1.6011-4
- Federal Forms 8886, 8721, 8264, and Schedule M-3
- IRM 5.20.1 Abusive Tax Avoidance Transaction Program

Our tax shelter guidelines are based upon IRS determinations of reportable transactions. The IRS issues guidance regarding the transactions and whether they are abusive tax avoidance. This guidance has been issued since 1990 in the form of IRS Revenue Rulings, Notices, Regulations, and other publications. These eventually are included in the IRS's weekly Internal Revenue Bulletins and the semi-annual Cumulative Bulletins. Included in this chapter is the most recent IRS list of abusive and listed transactions, with links to the IRS summaries. The details and complexities of these transactions are not discussed in the chapter. If that is necessary, the auditor will need to research through the relevant IRS guidance. A good place to start would be the IRS website, then reviewing the issued notices, rulings, IRBs, and of course the respective regulation and code provisions.

III. GENERAL INFORMATION

As part of an ongoing effort with the IRS and nearly every state, Illinois passed P.A. 93-840 (effective July 30, 2004) to discourage participation in abusive tax avoidance transactions (ATATs). P.A. 95-707 (effective January 11, 2008) updated these provisions which reflected amendments to the IRC. In general, the laws mandate specific filing procedures and registration requirements for taxpayers participating in tax avoidance activities, as well as the promoters of ATATs.

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The Department sent out thousands of letters to taxpayers between October 15th and December 31st of 2004 alerting taxpayers of the Department's Voluntary Compliance Program (VCP) that ran from October 15, 2004 to January 31, 2005. Some of those letters were based on referrals received from the IRS as well as the states of California and New York that had identified certain individuals, corporations, partnerships and trusts as having potentially participated in an ATAT. Audit continues to compile ATAT information submitted by taxpayers and promoters.

The Department is responsible for conducting office or field audits on a certain number of these taxpayers that may have participated in an ATAT. Any adjustments made by the Department may be forwarded to the IRS as well as other states. Consequently, the Department will conduct audits regarding ATAT where there has been no prior contact by the IRS.

The IRS website for abusive tax transactions is at:

https://www.irs.gov/businesses/corporations/abusive-tax-shelters-and-transactions

After you are at this page, click on "Abusive Tax Shelters and Transactions".

A. BACKGROUND

Tax avoidance transactions have existed since the inception of the income tax, as taxpayers have sought avenues to avoid and evade paying taxes. In the landmark U.S. Supreme Court case Gregory v. Helvering, 293 U.S 465 (1935), the taxpayer used a series of transactions to understate her net capital gain on the sale of stock shares. The U.S. Supreme Court found that she had conducted a corporate reorganization, contributed stock to that new company, and then immediately dissolved the new company and sold the distributed shares on the same day with no other real purpose than to reduce her income tax on the sale of distributed stocks.

From this case came two important tax legal doctrines: the business purpose doctrine and substance over form doctrine. Courts applying the business purpose doctrine disregard a transaction where it had no business purpose other than to reduce federal income tax. Courts applying the substance over form doctrine recharacterize a transaction when the economic substance was different than the legal form of a transaction. Both doctrines are a means of combating ATATs.

During the 1970s there was a spike in federal tax avoidance schemes. In 1984, the IRS began requiring taxpayers to register tax shelters and promoters to maintain investor lists. Over time, Congress also implemented some other statutory procedures in the code. Some of those provisions were the following:

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- IRC § 1281, Deferrals
- IRC § 1258, Conversion
- IRC § 246(c), Arbitrage
- IRC § 269, Carry-over basis
- IRC § 446, Method of accounting
- IRC § 482, Reallocation of items, related parties
- IRC § 7701(l), Multi-party transactions

The IRS implemented some key regulations in the 1990s to counter ATATs.

- Partnership anti-abuse rule (1994) – 26 CFR § 1.701-2(a)
- OID anti-abuse rule (1996) – 26 CFR § 1.1276-2(g)
- Consolidated return anti-abuse rule – Language included to prevent ATATs (e.g. 26 CFR § 1.1502-13(h))

The federal judiciary, in addition to the business purpose and substance over form doctrines, developed a third doctrine that confronted ATATs: the economic substance doctrine. This doctrine denies benefits to the taxpayer if the economic substance of a transaction is insignificant to the tax benefits obtained.

All of these developments were useful but did not eliminate taxpayer creativity and efforts to evade tax liability. On February 28, 2000, the IRS issued temporary regulation § 1.6011-4 which was finalized in 2003. This regulation prescribed the disclosure of reportable transactions, including listed transactions that the IRS has determined to tax avoidance transactions. In March 2003 the federal Form 8886, Reportable Transaction Disclosure Statement, was issued for taxpayers to disclose their reportable transactions. To deal with lack of compliance, Congress updated the IRC under the American Jobs Creation Act (P.L. 108-357, effective October 22, 2004) with several penalty provisions for failure to disclose reportable transactions and participation in ATATs. Lastly, in July 2007 the IRS amended regulations § 1.6011-4 by eliminating book-tax differences and adding transactions of interest to the category of reportable transactions.

B. DEFINITIONS

The Department's ATAT program uses the terms "reportable transaction" and "listed transaction" that are copied from the IRS definitions. These two terms are used throughout this chapter and are essential to the ATAT penalties imposed by the Department. IAC § 100.5060(a) defines them as follows:

Requirement to Disclose Participation in Reportable Transactions

1) In general. For each taxable year in which a taxpayer is required to make a disclosure statement under Treasury Regulations Section 1.6011-4 (26 CFR

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1.6011.4 (2004)) with respect to a reportable transaction in which the taxpayer participated in a taxable year for which a return is required under IITA Section 502, the taxpayer shall file a copy of such disclosure with the Department. (IITA Section 501(b)) A copy of such disclosure shall be filed at the time and in the manner provided under subsection (b) of this Section.

2) Definitions. For purposes of this Section:

A) Reportable Transaction. A "reportable transaction" is any transaction that must be disclosed under Treasury Regulations Section 1.6011-4 and shall include any listed transaction that is required to be disclosed under Treasury Regulation Section 1.6011-4T or 1.6011-4 as of the earlier of the date disclosure is required under subsection (b)(1) of this Section or the date the taxpayer files its return to which such disclosure would need to be attached.

B) Listed Transaction. A "listed transaction" is any transaction entered into after February 28, 2000 that is the same as or substantially similar to one of the types of transactions that the IRS has identified by notice, regulation, or other form of published guidance as a listed transaction and that is required to be disclosed under Treasury Regulation Section 1.6011-4T or 1.6011-4.

The following definitions come from the Internal Revenue Manual (IRM 4.32.1-1) and are frequently used terms regarding abusive tax avoidance transactions.

1. Tax Shelter -- A tax strategy or promotion that "shelters" income from normal taxation. Depending on the facts and legal analysis, a specific transaction or promotion may represent either lawful tax avoidance or unlawful tax evasion. Those tax shelters resulting in tax evasion are known as abusive tax shelters. The term "tax shelter" is sometimes used to mean "abusive tax shelter" in common parlance.

2. Abusive Tax Shelter -- Specific tax transaction/promotion that "shelters" income from normal taxation by taking a tax position that is not supported by tax law or manipulates the law in a way that is not consistent with the intent of the law (tax evasion). The term "Abusive Tax Shelter" is commonly used to mean an abusive tax transaction or promotion that is highly technical and represents a strategy that is often marketed by an accounting or law firm. These transactions may sometimes be referred to as "abusive promotions." When IRS identifies an abusive tax shelter as a listed transaction, that shelter is then subject to disclosure requirements pursuant to Treas. Regs. 1.6011-4. See listed transaction below in this table for a complete description. Not all abusive tax shelters are listed transactions.

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3. Reportable Transactions -- Reportable transactions include the following:
   - Listed transactions
   - Transactions offered under conditions of confidentiality
   - Transactions subject to contractual protection
   - Loss transactions
   - Transactions of interest.

   See Treas. Reg. 1.6011-4(b) for more information regarding the types of reportable transactions. Just because a transaction is a reportable transaction does not make that transaction an abusive tax shelter. Taxpayers must disclose their participation in reportable transactions as provided in Treas. Reg. 1.6011-4(e). If taxpayers do not disclose their participation in the reportable transaction, they will be subject to penalty pursuant to IRC 6707A (up to $50,000 for non-listed reportable transactions or $200,000 for listed transactions). In addition, material advisors must maintain and furnish lists of certain investor information with respect to reportable transactions under IRC 6112 and Treas. Reg. 301.6112-1 or be subject to penalty pursuant to IRC 6708. Per the American Jobs Creation Act of 2004 (Pub.L. No. 108-357), material advisors must disclose reportable transactions pursuant to IRC 6111 and Treas. Reg. 301.6111-3 or be subject to penalty under IRC 6707.

4. Listed Transaction -- A transaction is a reportable transaction subject to disclosure pursuant to Treas. Reg. 1.6011-4(a) and (b)(1) and IRC 6111, and for which material advisor lists must be maintained pursuant to IRC 6112. A transaction is a listed transaction if it is the same as or substantially similar to a transaction the IRS has identified as a listed transaction by published guidance. A transaction is substantially similar if it is expected to obtain the same or similar types of tax consequences and is either factually similar or based on the same or similar tax strategy as that described in the published guidance. When the IRS identifies a transaction as a listed transaction, it considers the transaction to be an abusive tax avoidance transaction.

5. Frivolous Tax Promotion/Scam -- A transaction/promotion that is clearly unallowable or has no existing basis in law such as the slavery reparations credit or IRC 861 arguments (taxpayer claims that their income is not taxable or that withholding is not applicable).

6. Transactions of Interest -- A transaction of interest (TOI) is a reportable transaction subject to disclosure pursuant to Treas. Reg. 1.6011-4 and IRC 6111, and for which material advisors must maintain lists pursuant to IRC 6112. A transaction is a transaction of interest if it is the same as or substantially similar to one of the types of transactions that the IRS has identified by published guidance as a transaction of interest. A transaction is substantially similar to a transaction of interest if it is expected to obtain the same or similar types of tax consequences and is either factually similar or based on the same or similar tax strategy as that described in the published guidance.

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TOIs are transactions that the IRS is interested in gathering more information about that could potentially be abusive tax shelters.

See the "EXHIBITS" section for more information from and links to IRS webpages regarding reportable transactions.

C. FEDERAL DISCLOSURE FORMS

The following describes some of the primary disclosure forms that are or were required of participants and promoters. The descriptions below will mention if the form has been replaced or not.

1. Participant Forms

A) Form 8886 Reportable Transaction Disclosure Statement

This form is for the taxpayer to disclose information for each reportable transaction in which they participated. The form applies to transactions entered into after December 31, 2002. Prior to that date, Treasury regulations prescribed the proper format for making disclosure. This form should identify the scheme, amount of benefits, as well as identify the promoter.

Generally, a separate federal Form 8886 must be filed for each reportable transaction, but more than one transaction may be listed on the form if the transactions are the same or substantially similar. The form instructions include a listing of the various reportable transactions. This is where an auditor can find most of the information to identify an ATAT.

B) Schedule M-3

Starting with taxable years ending on or after December 31, 2004, the IRS replaced Schedule M-1 with the Schedule M-3 for corporations with assets of $10 million or more. Schedule M-3 provides a detailed reconciliation from the taxpayer's financial accounting net income to its taxable income.

For tax year 2006, the IRS extended the filing requirement for Schedule M-3 to other returns, including partnerships, Subchapter S corporations, and insurance companies. These Schedules M-3 are based largely upon the format used for the Form 1120 and modified as appropriate.

The Form 1120 Schedule M-3 has three parts:

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- Schedule M-3, Part I, asks certain questions about the corporation's financial statements and reconciles financial statement net income (loss) for the corporation (or consolidated financial statement group, if applicable), as reported on Part I, line 4a, to net income (loss) of the corporation for U.S. taxable income purposes, as reported on Part I, line 11.

- Schedule M-3 Parts II and III reconcile financial statement net income (loss) for the U.S. corporation (or consolidated tax group, if applicable), as reported on Schedule M-3, Part I, line 11, to taxable income on Form 1120, page 1, line 28.

As explained in IRS Notice 2006-6, transactions with significant book/tax differences, are no longer reportable transactions.

C) Form 8271

Form 8271 Investor Reporting of Tax Shelter Registration Number was used to report the tax shelter registration number that the IRS assigns to certain tax shelters required to be registered under IRC § 6111. In 2007, the form was discontinued and now taxpayers can report the registration number on the Form 8886.

D) Form 8275

Form 8275 Disclosure Statement is used by taxpayers and tax return preparers to disclose items or positions, except those taken contrary to a regulation, that are not otherwise adequately disclosed on a tax return to avoid certain penalties. The form is filed to avoid the portions of the accuracy-related penalty due to disregard of rules or to a substantial understatement of income tax for non-tax shelter items if the return position has a reasonable basis. It can also be used for disclosures relating to the economic substance penalty and the preparer penalties for tax understatements due to unreasonable positions or disregard of rules.

E) Form 8275-R

Form 8275-R Regulation Disclosure Statement is used by taxpayers and tax return preparers to disclose positions taken on a tax return that are contrary to Treasury regulations. The form is filed to avoid the portions of the accuracy-related penalty due to disregard of regulations or to a substantial understatement of income tax for non-tax shelter items if the return position has a reasonable basis. It can also be used for disclosures relating to the economic substance penalty and the preparer penalties for tax understatements due to positions taken contrary to regulations.

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2. Material Advisor/Promoter Forms

A) Form 8918

Form 8918 Material Advisor Disclosure Statement: This form replaced Form 8264 in 2007 and is used for material advisors (i.e. organizers, promoters) to disclose information about their participation in reportable transactions.

B) Form 8264

Form 8264 Application for Registration of a Tax Shelter was used by organizers of certain tax shelters to register the transaction with the IRS, and was replaced by Form 8918.

D. ILLINOIS DISCLOSURE REQUIREMENTS

IITA § 501(b) contains the requirements for the disclosure of reportable transactions. These requirements are further clarified in IAC § 100.5060. Basically, Illinois disclosure consists of providing the Department copies of whatever disclosure forms the IRS requires.

A check box was added to the Form IL-1120 starting in 2005 that taxpayers marked if they filed a federal Form 8886 or Schedule M-3 to disclose a reportable transaction, and instructions were added to Illinois tax returns requiring taxpayers to attach to their Illinois return whatever disclosure forms were required to be attached to their federal returns. The form instructions tell taxpayers to mail a duplicate copy of their federal disclosure form(s) to the following address:

Illinois Department of Revenue
P.O. Box 19029
Springfield, IL 62794-9029

Filing a duplicate copy was required by IAC § 100.5060(b). This was the same P.O. Box number used for our first Amnesty program.

Note: The taxpayer is only required to attach the federal Schedule M-3 to the Illinois return if it was used to disclose a tax shelter for federal income tax purposes. If the taxpayer's federal return has a Schedule M-3, then the auditor will have to check to see if it discloses a reportable transaction, and if so, check to see that a copy was attached to the Illinois return or mailed to the Department's P.O. Box number.

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The taxpayer must file a copy of the federal disclosure form with the Department for each taxable year in which a taxpayer is required to make a federal disclosure statement under CFR §1.6011-4, even if it is for the same reportable transaction as in the prior year.

1. Participant Requirements

A) Disclosure Requirement

If you have Illinois nexus and are, or were, required to file federal Form 8886 (or a similar form prescribed by the IRS) with your federal income tax return, you are required to submit a copy of the federal form to the Illinois Department of Revenue for each taxable year that you are required to make a federal disclosure.

B) Due Date for Disclosure

Disclosure of participation in a reportable transaction (including listed transactions) must be made by the due date (including extensions) of the Illinois income tax return. If the federal due date is later than this date, the disclosure must be made no later than the federal due date.

C) Manner of Disclosure

Illinois requires that you submit two copies of the form used to disclose the transaction to the IRS: One copy of the federal disclosure statement (Form 8886 or a similar form prescribed by the IRS such as the Schedule M-3, or Form 8271) must be attached to your Illinois income tax return for the tax year that the IRS disclosure was required. In all cases, except the last situation outlined below, a second copy must be sent to the following address:

Illinois Department of Revenue
P.O. Box 19029
Springfield, IL 62794-9029

1) Current-year Disclosure, TYE on or after December 31, 2004

With respect to reportable transactions in which the taxpayer participated for taxable years ending on and after December 31, 2004, disclosure must be made at the time disclosure is required under CFR §1.6011-4(e). If the taxpayer discloses a reportable transaction on the federal return, a copy must be attached to the Illinois return for the same taxable year. Ref: IAC § 100.5060(b)(2)(B).

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In addition, the taxpayer is required to mail a duplicate copy of the federal disclosure forms (not a copy of the Illinois return) to the following address:

Illinois Department of Revenue
P.O. Box 19029
Springfield, IL 62794-9029.

If no Illinois return is due under IITA § 502, then the taxpayer must mail one copy of the federal disclosure to this P.O. Box. However, at this time we will not penalize the taxpayer for filing only one copy of the federal disclosure forms.

2) Members of Combined Group

If any member of the combined group is required to file a disclosure statement for a taxable year taken into account in computing the group's combined net income, a copy must be attached to the Illinois combined return. If a member of a combined group is required to file a disclosure statement related to a taxable year for which it was not a member of the combined group, a copy should be filed with the combined return. The designated agent should indicate that such statement relates to a separate return year of the member and indicate the taxable year to which the disclosure relates. See IAC § 100.5060(c)(1).

3) Members of Unitary Business Group

If any member of a unitary business group is required to file a disclosure statement for a taxable year taken into account in computing the group's combined net income, a copy must be attached to the Illinois combined return. See IAC § 100.5060(c)(3).

4) Partner or Shareholder

If a taxpayer is required to make a disclosure with respect to a transaction engaged in during the taxable year by a partnership or Subchapter S corporation in which the taxpayer is a partner or shareholder, the taxpayer's obligation to make disclosure with respect to the transaction shall be met if the disclosure is made by the partnership or Subchapter S corporation on a timely composite return that includes the taxpayer. See IAC § 100.5060(c)(4)

The partner or shareholder may choose to fulfill disclosure requirements by mailing the federal disclosure form directly to the Department. The partner or shareholder is responsible for ensuring that the Department receives any required documents by the due dates indicated. For example, if a partnership indicates that the disclosure will be filed with the composite return, and

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partnership fails to do so, the partner is ultimately responsible, not the partnership. Ref: Informational Bulletin FY 2005-17

For TYE on or after December 31, 2014, the composite return will be retired. Thus, presumably disclosure will be able to be done through the respective Forms IL-1065 and IL-1120-S, since these forms will be used to accomplish what was done through the retired Form IL-1023-C.

5) Protective Disclosure

Taxpayers that believe they do not have a filing requirement under IITA § 502 but have participated in a reportable transaction can still file the appropriate reportable transaction disclosure with Illinois and explain their lack of a filing requirement under IITA § 502. This will protect the taxpayer regarding the reportable transaction filing requirement under IITA § 501(b). See IAC § 100.5060(e).

6) Current-year Disclosure, TYE before December 31, 2004

As previously stated, Illinois disclosure consists of providing the Department copies of whatever disclosure forms the IRS requires. IAC § 100.5060 specifically refers to federal Form 8886 and the federal Schedule M-3.

IITA § 501(b) requires that taxpayers disclose to the Department any transaction entered into after February 28, 2000 that becomes a listed transaction at any time.

If the transaction is required to be disclosed for federal purposes on a return filed for a taxable year ending before December 31, 2004, then Illinois disclosure must be made by attaching a copy of the federal disclosure to the first Illinois return with an original due date (without regard to extensions) on or after July 30, 2004, the effective date of PA 93-840. For a calendar year taxpayer, this would be the 2004 return. Ref: IAC § 100.5060(b)(2)(A).

If disclosure is being made for an earlier taxable year, then copies of back federal disclosure forms had to be attached to the current Illinois return and clearly marked that the disclosure forms are for earlier years.

Example #1

The taxpayer filed its calendar year 2003 federal Form 1120 and attached Form 8886 and checked the box on line 2b for a “Confidential transaction”. The taxpayer neither discloses the transaction on its 2004 Form IL-1120

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nor mailed the form to our P.O. Box number. The auditor discovers that the transaction was entered into on October 1, 2002. Since the transaction was entered into prior to February 28, 2003, and it was not a listed transaction, no Illinois disclosure was required.

Example #2

On the 2003 federal Form 1120, the taxpayer checked box 2a on Form 8886 for a listed transaction. The taxpayer failed to attach a copy to its 2004 Form IL-1120. Regardless of what the listed transaction was for or whether or not tax was owed on the transaction, the taxpayer will be subject to a $30,000 IITA § 1001(b)(2) penalty subject to the 10% limitation in IITA § 1001(c). Although the Form 8886 was attached to the 2003 federal return, the penalty is imposed for 2004 since that is the year when Illinois disclosure was required.

Example #3

Corporation A was required under CFR §1.6011-4 to disclose reportable transactions by attaching Form 8886 and/or Schedule M-3 to its federal income tax return for its taxable year ending March 31, 2003. Corporation A may elect to attach copies of Form 8886 and Schedule M-3 to its Illinois income tax return for its taxable year ending March 31, 2004. If it does not make this election, Corporation A is required to attach copies of Form 8886 and Schedule M-3 to its Illinois income tax return for the taxable year ending March 31, 2005, which is the first return for which the unextended due date falls on or after July 30, 2004. In either case, Corporation A must indicate that Form 8886 and Schedule M-3 relate to its March 31, 2003, taxable year. Ref: IAC § 100.5060(b)(2) example.

2. Material Advisor/Promoter Requirements

As a backstop to investor disclosure, the IRS requires that tax professionals that promote these potential ATATs file returns disclosing these transactions to the IRS and then keep a list of investors in the transaction. Illinois coupled onto this promoter disclosure beginning January 11, 2008.

Two new sections were added to the Act for this disclosure, IITA §§ 1405.5 (promoter's IRS transaction disclosure) and 1405.6 (promoter's IRS investor list).

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IITA § 1405.5(a) states:

> Federal tax shelter. Any material advisor required to make a return under Section 6111 of the Internal Revenue Code with respect to a reportable transaction shall send a duplicate of the return to the Department not later than the day on which the return is required to be filed under federal law.

IITA § 1405.6(a) states:

> Federal abusive tax shelter. Any person required to maintain a list under Section 6112 of the Internal Revenue Code shall furnish a duplicate of such list to the Department not later than the earlier of the time such list is required to be furnished to the Internal Revenue Service for inspection under Section 6112 of the Internal Revenue Code or the date of written request by the Department.

IITA §§ 1405.5(c) and 1405.6(c) describe the transactions subject to promoter disclosure, which are reportable transactions that have nexus with Illinois. Department regulations were issued in 2009 that outline how promoters are to comply with promoter disclosure. IAC § 100.5080 pertains to IITA § 1405.5 and outlines the disclosure required by promoters for the tax shelter or reportable transaction. IAC § 100.5070 pertains to IITA § 1405.6 and outlines the disclosure of investor lists. Care should be applied when reviewing the disclosure requirements, which our regulations explain, because of federal law changes. Effective October 22, 2004, the term “tax shelter” was deleted from IRC §§ 6111 and 6112. IITA §§ 1405.5(b) and 1405.6(b) required disclosure for transactions that became listed until P.A. 95-707 repealed those subsections January 10, 2008. After January 10, 2008, returns and lists required to be filed with the IRS under IRC § 6111 must be provided to the Department.

A) Standard Disclosure Requirements

If a material advisor is required to file a federal Form 8918 Material Advisor Disclosure Statement (or a similar form prescribed by the IRS such as Form 8264) with respect to a reportable transaction having nexus with Illinois, it is required to submit a copy of that federal form to the Illinois Department of Revenue.

B) Due Date

For federal income tax purposes, the IRS requires material advisors to make disclosures by the last day of the month following the end of the applicable calendar quarter in which the advisor became a material advisor for the reportable transaction. Illinois requires that the copy of the federal form be filed with the Department on the same date as the federal filing. This means both the federal and Illinois due dates are January 31, April 30, July 31, or October 31.

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C) Manner of Disclosure

1) Standard Disclosure Manner

A copy of the federal form (Form 8918 or similar form prescribed by the IRS) must be furnished to the Department at the following address:

Illinois Department of Revenue
P.O. Box 19029
Springfield, IL 62794-9029

2) Investor Lists for Reportable Transactions

Material advisors are also required to maintain a list under IRC § 6112 identifying each taxpayer for whom the person provided services as a material advisor with respect to a reportable transaction. A duplicate copy of the investor list provided to the IRS must be provided to Illinois when the reportable transaction has nexus in Illinois. It is to be furnished not later than the following dates: the same date as it is required to be furnished to the IRS, or the date that is specified in a written request by the Department.

IV. AUDITING ATAT ISSUES

A. REVIEWING AUDIT

On every audit the auditor will need to check if the taxpayer has disclosed a reportable transaction to the IRS either on federal Forms 8886, 8271 (prior to 8/2/07), 8264 (prior to 10/31/07), 8918 (replaced Form 8264), 8275, 8275-R or Schedule M-3. The principal federal form on which taxpayers disclose reportable transactions will be the federal Form 8886. Promoters ("material advisors") currently disclose on federal Form 8918. IITA § 501(b) requires Illinois disclosure of reportable transactions, whether or not tax is ever due from these transactions. Failure to make disclosure may subject the taxpayer to a flat $15,000 penalty on a reportable transaction or $30,000 on listed transactions subject to a 10% limitation under IITA § 1001(c).

The taxpayers do not owe federal or state tax just because they engaged in a listed transaction considered abusive by the IRS. In order to adjust federal taxable income, we would have to apply the criteria in IRS notices and publications regarding that transaction before determining if the transaction is abusive. Consequently, in most cases we are not going to adjust federal taxable income to reverse abusive tax shelters unless there is a federal RAR. When auditing returns that have not been federally audited, emphasis should be placed on the taxpayer properly disclosing any reportable transactions to Illinois.

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However, we can still audit the transaction and adjust federal taxable income, and then report that change to the IRS.

Refer to the section "ILLINOIS DISCLOSURE REQUIREMENTS".

Next, the auditor will need to consider if any user penalties apply if the taxpayer underreported income to Illinois because of an ATAT. The applicable penalty rate is multiplied by the penalty base, which is basically the underreported income due to the ATAT times the applicable tax rate.

On all RARs the auditor will have to examine a detailed breakdown of the RAR adjustments and determine what portion, if any, was the result of a reportable transaction for purposes of assessing the IITA § 1005(b)(1) reportable transaction understatement penalty and IITA § 1005(c) 100% interest penalty. The ATAT adjustment to federal taxable income will have to be documented on a separate schedule, and applicable ATAT penalties computed on that tax.

Just because the taxpayer engaged in a listed transaction does not mean that tax or penalty is owed from it. Once the tax shelter has been identified, the auditor should refer to IRS notices and other published IRS guidance to determine if the shelter is abusive and whether or not the auditor should refer the case to the IRS.

Refer to the section "ATAT PENALTIES AND INTEREST".

Lastly, the auditor will need to consider if promoter penalties are applicable. These penalties were created with the other ATAT legislation in 2004 and updated by P.A. 95-707 in 2008 to reflect IRS changes. They require the promoters to disclose the tax shelters and investor lists to the Department or face penalties.

Refer to the section "PROMOTER PENALTIES".

B. 6-YEAR STATUTE

Public Act 93-840 provides for a six-year statute for issuing notices of deficiency (NODs). IITA § 905(b)(2) states:

> Reportable transactions. If a taxpayer fails to include on any return or statement for any taxable year any information with respect to a reportable transaction, as required under Section 501(b) of this Act, a notice of deficiency may be issued not later than 6 years after the return is filed with respect to the taxable year in which the taxpayer participated in the reportable transaction and said deficiency is limited to the non-disclosed item.

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The effective date of P.A. 93-840 is July 30, 2004. This gives the Department a six-year statute from the extended due date of the return or the date the return was filed, whichever is later, in order to assess tax from an undisclosed reportable transaction. Any deficiency under this statute is limited to the non-disclosed item. This statute however only applies to returns where the taxpayer has not disclosed involvement in a reportable transaction on an original return or an amended return. In addition, in order to apply this six-year statute, the normal statute of limitations could not have been expired as of July 30, 2004, the effective date of P.A. 93-840, unless the auditor had a waiver to extend the statute.

Example #4

The audit is for calendar years 2003 and 2004. The auditor discovers that the taxpayer never disclosed a listed transaction for the year 2001 that indicates tax due (no amended return was filed for 2001). The 2001 return was filed timely, so the normal three-year statute of limitations under IITA § 905(a)(1) is October 15, 2005. The statute on the 2001 return was open at the time P.A. 93-840 became effective; therefore the statute date under IITA § 905(b)(2) is six years from the extended due date of the 2001 return, which on an IL-1120 would be October 15, 2008. However, this extended statute can only be used to assess tax, penalty, and interest from the ATAT.

Note: Even if the return is out-of-statute, it is possible that the 25% omission of income statute in IITA § 905(b)(1) could apply. This statute is discussed in Chapter 21 of the Audit Manual.

Example #5

The taxpayer filed a Form IL-1120-X, along with a VCP-1 on January 31, 2005 for calendar year 2001 to report tax due on a listed transaction that increased a federal capital gain. No amended federal return was filed and there is no Illinois waiver for this year; therefore, the normal statute of limitation in IITA § 905(a)(1) expired on October 15, 2005. The new six-year statute in IITA § 905(b)(2) does not apply since the reportable transaction was disclosed on an amended return.

If the new ATAT statute does not apply, then IITA § 905(a)(1) generally provides that a notice of deficiency shall be issued not later than three years after the date the return was filed. However, IITA § 905(b)(1) extends that limitation period to six years if a taxpayer omits from base income an amount properly includible therein which is in excess of 25% of the amount of base income stated in the return. In addition, IITA § 905(e)(1) states that where notification of a federal change is given, a notice of deficiency may be issued at any time within two years after the date such notification is given, provided that the notice is limited to the amount of the deficiency resulting from the recomputation of the taxpayer's Illinois net income after giving effect to the federal change.

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Refer to Chapter 21 of the Audit Manual for more information on the statute dates for federal and state changes.

C. FORM EDA-130

When beginning any new audit, especially a case where an abusive tax shelter is suspected, the auditor should provide the taxpayer with Form EDA-130, Information Document Request for Tax Avoidance Transactions, intended to provide the auditor with information on any possible federal tax shelters. Also, in the case of a regular audit where no abusive tax shelter activity is suspected, there is a statement at the bottom of the first page of the form that the taxpayer can sign to indicate no involvement in any reportable transactions. This form will be mailed to the taxpayer at the start of every new audit including audits where there is no evidence of an abusive tax shelter. The EDA-130 may be attached to appointment initiation letters. The EDA-130 is available as a fill-in form on the intranet under "Audit" and then "Forms". The form has also been copied and is located in the "EXHIBITS" section of this chapter.

The document request Form EDA-130 lists the following items:

1. A description of all listed and reportable transactions including all of the material facts.

2. A description of the tax treatment of all listed or reportable transactions that resulted in a tax benefit.

3. Information identifying the amounts involved and the General Ledger accounts affected by any part of any listed or reportable transactions. Please trace all identified items and amounts as line items on the tax returns.

4. Copies of all contracts and other documents pertaining to any listed transaction.

5. The names and addresses of all parties who promoted, solicited, or recommended participation in any listed or reportable transaction, and to whom fees or other compensation were paid in connection with the transaction.

6. The details of any tax strategies that were disclosed to any other state.

7. Copies of requests made to the IRS to determine if any transaction you participated in should have been disclosed as a listed or reportable transaction. Include any responses you have received.

8. Details of any other state's tax shelter initiatives that you have responded to or entered into agreement with, including copies of signed agreements.

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9. Any federal Forms 8886 and 8271 that you filed with the IRS, but have not previously provided to the Illinois Department of Revenue.

At the opening conference with the taxpayer, there are additional questions that should be asked regarding abusive tax shelters:

- Are you currently under audit by the IRS?
  - For what years?
  - When do you expect it to be concluded?
  - Has the IRS requested any information regarding 'reportable transactions'? If so, please provide copies of all IDR requests made by the IRS.

- Have you filed amended returns with the IRS or any other taxing entity? If so, were any of those amended returns filed to correct items that the IRS considers 'Listed Transactions' or substantially similar transactions?

- Have you made any disclosures regarding tax-planning strategies to the IRS or any other state? Have you paid any fees for tax planning strategies?

V. ATAT PENALTIES AND INTEREST

A. USER PENALTIES

1. General Information – IITA § 1001(b), Failure To Disclose

If the taxpayer fails to properly disclose a reportable transaction, then the taxpayer may be subject to the non-disclosure penalty in IITA § 1001(b). The penalty has two rates:

- $15,000 for each failure to disclose a "reportable transaction"
- $30,000 for failure to disclose with respect to a "listed transaction"

Generally, the penalty applies to failure to disclose listed transactions entered into on or after February 28, 2000 and all other reportable transactions entered into on or after February 28, 2003. The penalty is deemed assessed upon filing the return. Both penalties are subject to a 10% limitation as explained later in this chapter. Assessing this penalty is explained later in this chapter.

Under IITA § 501(b) and IAC § 100.5060, the taxpayer is required to file with Illinois whatever disclosure forms the taxpayer filed federally under 26 CFR § 1.6011.4 (2004). IAC § 100.5060 along with the Form IL-1120 and form instructions specifically refer to federal Form 8886 and Schedule M-3, but other federal disclosure forms may apply.

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2. Assessing the IITA § 1001(b) Penalty

IITA § 1001(b) imposes a penalty for each failure to disclose participation in a reportable transaction as required under IITA § 501(b). The penalty is $15,000 for each failure to disclose the transaction ($30,000 in the case of a listed transaction). Both penalties are subject to the 10% limitation in IITA § 1001(c).

Example #6

The taxpayer attached three Forms 8886 to their federal return for 2004: one is for a listed transaction and the other two are for reportable transactions. If the taxpayer does not attach the Forms 8886 to their Illinois return or send copies to our P.O. Box number, then the combined IITA § 1001(b) penalty for 2004, subject to the 10% limitation, will be $60,000 ($30,000 + (2 x $15,000)).

The penalty will be imposed in the year that Illinois disclosure was required. For example, if the IITA § 1001(b) penalty is applicable for a transaction entered into in 2003 and disclosed on the 2003 federal tax return, then the penalty will be assessed on the first Illinois return due after July 30, 2004 (without extensions). On a calendar year filer this will be the 2004 Illinois return.

Currently there is no mechanism in the field for assessing the IITA § 1001(b) penalty. Since the penalty is deemed assessed, the penalty is not included on the IL-870 nor is it included on the EDA-122. The penalty must be assessed on a Notice and Demand issued by Technical Review.

The auditor will have to request a separate track for whatever year(s) we are imposing the IITA § 1001(b) penalty. GenTax will show the earliest extended due date as the statute date. The auditor will submit an audit report that will include the Prod-1, EDA-27, EDC-5, a calculation of the penalty on a separate worksheet, and the Auditor's Comments.

Note: IITA § 902(a) will not extend the time for issuing a Notice and Demand to the taxpayer on deemed assessed penalties. Consequently the IL-872 cannot be used to extend the statute on this penalty.

Example #7

The audit is for calendar years 2002 and 2003. If the auditor finds a federal Form 8886 attached to the 2002 federal return and it is for a "listed transaction" entered into after February 28, 2000, then the auditor will check to see if this form was attached to the 2004 calendar year Illinois return and whether or not the form was mailed to the P.O. Box number above. If there is no record that Form 8886 was filed with the Department,

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then the $30,000 IITA § 1001(b)(2) penalty will be assessed on a Notice and Demand for 2004. However, the 10% limitation will be computed using the 2002 Illinois net income or Illinois net loss figures reported. The Notice and Demand will have to be issued before the IITA § 903(a) statute expires, which would be three years from the date the 2004 return was filed.

Note: There have been some cases where the Form 8886 has disclosed transactions that did not require disclosure under IITA § 501(b), so that no penalty was due from failure to file the Form 8886. If the taxpayer feels that the Form 8886 did not have to be filed with Illinois, the taxpayer will have to provide the auditor with a written explanation. The auditor will then submit it to Technical Support, and it will be forwarded to Legal Services for review.

Example #8

Taxpayer federally filed a 2012 Form 8886 disclosing a reportable transaction under protective disclosure. On audit, it is determined that Taxpayer was an Illinois nonfiler that should have filed a Form IL-1120. Taxpayer did not file any disclosure of the reportable transaction with Illinois. The auditor determines that federal disclosure was merely protective, and was not a reportable transaction required to be reported under CFR § 1.6011-4. As a result, Taxpayer had no disclosure requirement under IITA § 501(b), and no Illinois disclosure penalty will be applicable.

Example #9

Taxpayer federally filed a 2010 Form 8886 disclosing a reportable transaction, and on audit is found to have failed to have provided disclosure to Illinois. The transaction resulted in a $10,000,000 reduction in federal taxable income. Taxpayer has a 13% apportionment factor and reported Illinois net income of $15,000,000. Thus, the Illinois net income without the reportable transaction would have been $16,300,000 ($15,000,000 + ($10,000,000 x 13%)). The IITA § 1001(b) 10% limit, is (($16,300,000-$15,000,000) x 10%)), or $130,000. The penalty then is $15,000, as the 10% limitation exceeds the statutory penalty.

See the “10% Penalty Limitation” section for more explanation on this limit.

The IITA § 1001(b) penalty can be imposed in addition to any other ATAT penalty or UPIA penalty subject to the limitations above. Although UPIA penalty and interest are doubled for years that apply to the former Amnesty programs, none of the ATAT penalties are doubled for Amnesty periods.

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The reasonable cause provisions for the IITA § 1001(b) penalty, as amended by P.A. 95-0707 are as follows:

> **Section 1001(b)(3) Authority to rescind penalty.** The Department may rescind all or any portion of any penalty imposed by this subsection with respect to any violation, if:
>
> A. The violation is with respect to a reportable transaction other than a listed transaction, and
>
> B. Rescinding the penalty would promote compliance with the requirements of this Act and effective tax administration; or
>
> A determination made under this subparagraph (3) may be reviewed in any administrative or judicial proceeding.

Under these provisions the penalty cannot be abated on any listed transaction. Note that in IITA § 1001(b) the penalty is deemed assessed upon filing the return and is automatically imposed once the return is filed. Under the statute the penalty can only be "rescinded". If the taxpayer feels that any penalty imposed should be rescinded under the statute, then the taxpayer will have to provide the auditor with a letter (preferably in electronic form) on why the penalty should be rescinded. This letter should then be emailed to Technical Support who will then forward it on to Legal Services for review.

Note: To date, regulations have been issued on different ATAT disclosure requirements and VCP, but not on any of these abusive tax shelter penalties.

3. 10% Penalty Limitation

There is a special 10% limitation unique to the IITA § 1001(b) penalty. This limitation does not apply to the other ATAT penalties listed in this chapter. IITA § 1001(c) states, in part:

> The total penalty... with respect to any taxable year shall not exceed 10% of the increase in net income (or reduction in Illinois net loss under Section 207 of this Act) that would result had the taxpayer not participated in any reportable transaction affecting its net income for such taxable year.

Before assessing this penalty the auditor should determine what the 10% limitation is under this section. Note that the limitation is not based on any tax computation, but upon the change to Illinois net income or Illinois net loss from reversing the ATAT. If

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the auditor cannot determine what the tax effect of the ATAT is for purposes of determining the 10% limitation, then the auditor will inform the taxpayer that the 10% limitation may apply and then let the taxpayer prove that the 10% limitation is less than the penalty being assessed.

Example #10

The taxpayer filed its original return showing negative Illinois base income of ($100,000). The Illinois apportionment factor is 10%; therefore, the Illinois net loss under IITA § 207 is $(10,000) which includes the expected tax effect from a listed transaction. Form 8886 is supposed to list the federal tax benefit of the listed transaction, such as a change to federal taxable income, expense deductions, etc. If the federal tax benefit is a $50,000 deferred charge to income, then the correct Illinois net loss without the effects of the ATAT is $(5,000) [($100,000 – $50,000)] x 10%. Although the IITA § 1001(b)(2) penalty is $30,000, the 10% limitation is $500 [($10,000 - $5,000)] x 10%.

Example #11

For 2004 an individual reported negative adjusted gross income of ($100,000) which includes the tax benefits of an ATAT worth $200,000. So, without the ATAT, AGI would be a positive $100,000. The limitation is the change in net income or net loss due to the ATAT, times 10%. For a full-year resident net income is the amount subject to tax, which is base income less the standard exemption. Assuming that there are no modifications, the limitation is $20,000 [$100,000 – (-$100,000) = $200,000) x 10%]. If the taxpayer failed to disclose the transaction by attaching federal Form 8886 to his 2004 Form IL-1040, the taxpayer will owe an IITA § 1001(b) penalty of $15,000 if it was a reportable transaction or $20,000 penalty if it was a listed transaction ($30,000 penalty subject to the $20,000 limitation).

4. General Information – IITA § 1005(b), Underreporting Penalty

IITA § 1005(b)(6) states that the reportable transaction understatement penalty generally applies to taxable years ending on and after December 31, 2004. However, the paragraph contains a special rule for listed transactions:

> A reportable transaction understatement shall include an understatement (as determined under paragraph (1)) with respect to any taxable year for which the limitations period on assessment has not expired as of January 1, 2005 that is attributable to a transaction which the taxpayer has entered into after February 28, 2000 and before December 31, 2004 that becomes a listed transaction (as defined in Treasury Regulations Section 1.6011-4(b)(2)) at any time.

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Therefore in order to assess the IITA § 1005(b) penalty for tax years prior to December 31, 2004, the tax due would have to be from a listed transaction.

The IITA § 1005(b) penalty base is the reportable transaction understatement which is defined under IITA § 1005(b)(1) to be the product of (i) the amount of the increase in Illinois net income that results from a difference between the proper tax treatment of an item to which this subsection applies and the taxpayer's treatment of that item (as shown on the taxpayer's return of tax, including an amended return filed prior to the date the taxpayer is first contacted by the Department regarding examination of the return), and (ii) the applicable tax rates under IITA § 201.

The penalty under IITA § 1005(b) is generally equal to 20% of the understatement, but increases to 30% if the taxpayer failed to disclose the transaction as required under IITA § 501(b). UPIA penalties will also be due on any ATAT liabilities unless the liability is from an RAR that was reported and paid within 120 days of the finalization date. This penalty is explained later in this chapter.

5. IITA § 1005(b) Reportable Transaction Understatement Penalty

It must be determined if the ATAT late pay penalty under IITA § 1005(b) is applicable to the year that you are auditing. This penalty generally applies to taxable years ending on and after December 31, 2004. However, a special rule applies this penalty to listed transactions entered into after February 28, 2000. Most of the amended returns that were filed under the VCP were for listed transactions, but not all of them. The auditor must determine if the tax due is from a listed transaction if it is for a tax year prior to December 31, 2004. Prior to this date, if the tax due is only from a reportable transaction (other than a listed transaction), then none of the ATAT penalties apply. If the tax is due from a listed transaction, then the auditor will need to determine if it was a transaction entered into after February 28, 2000.

Example #12

The taxpayer files an amended return for calendar year 2002 under the VCP program to reverse the tax effects of a Son of Boss transaction, a listed transaction. It is determined that the amended return does not qualify for penalty relief under the VCP program. Although 2002 is a year that we can impose this penalty, if the taxpayer can show that the transaction was actually entered into prior to February 28, 2000, then no IITA § 1005(b) can be assessed.

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In order to calculate the penalty, the auditor must first determine:

- The penalty rate, and
- If an amended return was filed by the taxpayer to reverse the ATAT, determine if the original return or amended return will be used to calculate the penalty base.

Example #13

Taxpayer participated in a Lease In/Lease Out (LILO) transaction in 2005, which is a listed transaction. The transaction was properly disclosed to the Department in all applicable years. On federal audit, Taxpayer's federal taxable income was increased in tax years 2005 through 2010 as a result of the listed transaction. Taxpayer will owe an IITA § 1005(b) penalty for each period that Illinois net income was understated, and the penalty will be calculated at 20% due to proper Illinois disclosure.

6. Penalty Base and Rate

The penalty is generally equal to 20% of the reportable transaction understatement, but increases to 30% if the transaction was not disclosed as required under IITA § 501(b). The rules for making disclosure are stated in IAC § 100.5060, and were discussed previously in the "ILLINOIS DISCLOSURE REQUIREMENTS" section. The auditor should refer to that section to determine if the disclosure requirements under IITA § 501(b) were met. If not, then the penalty rate is 30%.

However IITA § 501(b) provides that no disclosure is required for transactions entered into after February 28, 2000 and before January 1, 2005 if:

- the taxpayer filed an amended Illinois income tax return which reverses the tax benefits of the ATAT transaction, or

- as the result of a federal audit the IRS has determined the tax treatment of the transaction and an Illinois amended return has been filed to reflect the federal treatment.

These exceptions to IITA § 501(b) disclosure apply to most of the amended returns filed under the VCP. Therefore, if we disqualify a taxpayer from the VCP and assess the IITA § 1005(b) penalty, the penalty rate will be 20% as long as the taxpayer met the above requirements.

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Example #14

The taxpayer files an amended return to reverse the tax effect of an ATAT prior to the time disclosure is due under IITA § 506(b) (it does not matter if they filed under the VCP) and increases federal taxable income by reversing the ATAT. The Department determines that additional tax is owed on the amended return because the taxpayer did not use the proper apportionment factor. Even though the taxpayer did not pay all of the tax from reversing the ATAT, the taxpayer did disclose its reportable transaction under IITA § 501(b), so the IITA § 1005(b) ATAT penalty will be 20% instead of 30%.

The penalty base is the reportable transaction understatement and is defined in IITA § 1005(b)(1) as the product of

- the amount of the increase in Illinois net income that results from a difference between the proper tax treatment of an item to which IITA § 1005(b) applies and the taxpayer's treatment of that item (as shown on the taxpayer's return of tax, including an amended return filed prior to the date the taxpayer is first contacted by the Department regarding examination of the return), and

- the applicable tax rates under IITA § 201.

If the taxpayer or the auditor is making adjustments to an amended return that reverses the tax effects of an ATAT, then the auditor will have to prepare a separate worksheet that calculates the effect on Illinois net income after apportionment of only the ATAT adjustment.

If the auditor is assessing additional tax on an amended return filed by the taxpayer that reversed the tax effects of an ATAT, then the auditor must determine if the Department contacted the taxpayer about our VCP program prior to the taxpayer filing the amended return. This determines if the original return or the amended return is considered in computing the penalty base.

If the Department did contact the taxpayer about our VCP program prior to an amended return being filed, then in computing the penalty base, the correct amount of Illinois net income, after reversing the effects of the tax shelter, is compared to the taxpayer's original return. If we have evidence that the Department sent the taxpayer a VCP letter prior to the date that the taxpayer filed its amended return, then the penalty base will be the difference between the corrected amount of Illinois net income from reversing the ATAT, minus the total Illinois net income on the original return, times the tax rate. If the Department **did not** contact the taxpayer about reversing the effects of a reportable transaction, then the correct net income amount on the taxpayer's amended return will be used in place of the original return.

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VCP law § 35-5(a) states that any correspondence mailed by the Department to a taxpayer at the taxpayer's last known address outlining the tax shelter voluntary compliance program constitutes a "contact" within the meaning of IITA § 1005(b)(6) and (c). IITA § 1005(b)(6) does not make reference to the term "contact," but does reference the definition of reportable transaction understatement under IITA § 1005(b)(1). Therefore, if a taxpayer receives a VCP letter prior to the time the VCP amended return was filed, and the taxpayer does not qualify for VCP because, for example, the VCP return was filed late, then the tax as shown on the amended VCP return is not considered in computing the reportable transaction understatement.

Example #15

IL-1120 Return	Original Return	VCP Amended Return	Corrected Return per Audit
Federal taxable income	10,000,000	15,000,000	20,000,000
Net subtraction modifications	(2,000,000)	(2,000,000)	(2,000,000)
Base Income	8,000,000	13,000,000	18,000,000
IL Factor	0.100	0.100	0.100
ILL Net Income	800,000	1,300,000	1,800,000
IL Tax Rate	0.073	0.073	0.073
Illinois tax	$58,400	$94,900	$131,400

A C-corp filed its original return taking advantage of an ATAT and pays $58,400 in Illinois income tax. The taxpayer was one of the thousands that received a VCP letter from the Department explaining the new VCP program. The taxpayer then files an IL-1120-X with the Department reversing the tax effects of the ATAT and reports total tax of $94,900, and pays $36,500 in additional tax ($94,900 - $58,400). The Department audits the amended return and determines that the taxpayer failed to properly report the ATAT and should have reported total tax of $131,400 and paid an additional $73,000 (131,400 - $58,400) with the amended return (Note: If the change is not ATAT related, then the taxpayer qualifies for VCP). If the taxpayer fails to pay the additional tax within 30 days, it will be disqualified from the VCP program. Since the taxpayer was contacted by the Department about the VCP, the penalty base is $73,000 ($131,400 - $58,400) and the IITA § 1005(b) penalty is $14,600 ($73,000 x 20%). In this example, if there is no evidence that we contacted the taxpayer about tax shelters, then the penalty base will be $36,500 ($131,400 – $94,900) and the IITA § 1005(b) penalty $7,300($36,500 x 20%)

Any penalty assessed is included on the IL-870.

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If reversal of the ATAT causes a reduction in a net loss or credit, the IITA § 1005(b) penalty may be applied in the carry year affected. IITA § 1005(b)(1)(B) states, in part:

> ...The penalty for an understatement of income attributable to a reportable transaction applies to any portion of an understatement for a year to which a loss, deduction, or credit is carried that is attributable to a reportable transaction for that year in which the carryback or carryover of the loss, deduction, or credit arises (the "loss or credit year").

Example #16.1

Taxpayer properly disclosed a listed transaction entered into in 2009. Under federal audit, the ATAT led to underreported federal taxable income. Taxpayer filed an amended return to report the Illinois liability due to the reversed ATAT, paying only the underreported tax. The 2009 amended return is set up to be audited. The auditor agrees with the underreported liability reported due to the reversed ATAT. The auditor must turn in the audit to Audit Perfection as quickly as possible to bill Taxpayer within the three year statute for any deemed assessed penalty and interest. Taxpayer will owe a 20% IITA § 1005(b) penalty. Below are Taxpayer's figures:

IL-1120 Return	Original Return	Amended Return per Audit
Federal taxable income	10,000,000	20,000,000
Net subtraction modifications	(2,000,000)	(2,000,000)
Base Income	8,000,000	18,000,000
IL Factor	0.100	0.100
ILL Net Income	800,000	1,800,000
IL Tax Rate	0.073	0.073
Illinois tax	$58,400	$131,400

Taxpayer's IITA § 1005(b) penalty base is $73,000 ($131,400-$58,400), so the IITA § 1005(b) penalty would be $14,600 ($73,000 x 20%).

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Example #16.2

Same facts as in Example #16.1, but instead of a underreporting net income, Taxpayer overstated its net loss, and the reversal of the ATAT leads to a reduced Illinois net loss, which was carried into 2010. Taxpayer's figures for 2009 are shown below:

IL-1120 Return	Original Return	Amended Return per Audit
Federal taxable income	(10,000,000)	(5,000,000)
Net subtraction modifications	(2,000,000)	(2,000,000)
Base Income	(12,000,000)	(7,000,000)
IL Factor	0.100	0.100
ILL Net Loss	(1,200,000)	(700,000)
IL Tax Rate	0.073	0.073

Taxpayer had already claimed and used the $(1,200,000) loss in 2010. Taxpayer should provide auditor a 2010 amended return reporting the correct reduced Illinois net loss deduction. The IITA § 1005(b) penalty would be assessed in 2010, and would be $7,300 (($1,200,000-$700,000) x .073 x 20%). If an admitted liability, this penalty would need to be billed within three years of filing the amended return. If proposed, then the penalty would be included on the IL-870.

7. Reasonable Cause Exception - IITA § 1005(b)(4)

IITA §1005(b)(4) provides the provisions for reasonable cause. This statutory language resembles the IRS's reasonable cause language for accuracy-related penalties under IRC § 6664. To summarize, for any reportable transaction understatement, the penalty can be abated if reasonable cause existed and the taxpayer acted in good faith. This requires the taxpayer demonstrate three things:

- Disclosure per IITA § 501(b) of the reportable transaction (unless rescinded by the Department)
- Substantial authority for the transaction
- Reasonable belief that the transaction was more likely than not proper

Further provisions and definitions are provided in IITA § 1005(b)(4), which must be reviewed and applied in a reasonable cause situation.

Currently, there are no regulations regarding reasonable cause abatement of any ATAT penalties. Requests from the field for abatement of ATAT penalties should be treated according to our reasonable cause procedures in Audit Manual Chapter 3 in conjunction with the statutory guidelines of IITA § 1005(b)(4).

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8. IITA § 1005(c) - 100% Interest Penalty

IITA § 1005(c) imposes the 100% interest penalty where a taxpayer has been contacted by the IRS or the Department regarding the use of a "potential tax avoidance transaction" for a taxable year and has a deficiency (i.e. correct amount of tax exceeds amount of tax reported) attributable to such transaction. The penalty is equal to 100% of the single interest assessed under the UPIA (the interest penalty is not doubled for Amnesty periods) for the period beginning on the last date prescribed by law for payment of such tax and ending on the date of the notice of deficiency.

The 100% interest penalty under IITA § 1005(c) applies if the taxpayer fails to report a federal change after the taxpayer was "contacted" by the IRS or the Department. Section 35-5(a) of the VCP law states that any correspondence mailed by the Department to a taxpayer at the taxpayer's last known address outlining the tax shelter voluntary compliance program constitutes a "contact" within the meaning of IITA § 1005(b) & (c). There may be some question as to whether the deemed contact rule in Section 35-5(a) of the VCP law should apply to tax avoidance transactions entered into after the effective date of the VCP law. A literal application of the rule would mean that a taxpayer notified of VCP could never again avoid a reportable transaction understatement penalty by filing an amended return to reverse a tax avoidance transaction prior to the time the Department initiated an audit. Nonetheless, the Department should apply a literal interpretation and condsider taxpayers notified of VCP as having been contacted FOR ALL TAXABLE YEARS for purposes of IITA § 1005(b)(1) and (c).

The IITA § 1005(c) penalty base is the same as the IITA § 1005(b) penalty base, that is, the reportable transaction understatement which is defined under IITA § 1005(b)(1) as the product of (i) the amount of the increase in Illinois net income that results from a difference between the proper tax treatment of an item to which this subsection applies and the taxpayer's treatment of that item (as shown on the taxpayer's return, including an amended return filed prior to the date the taxpayer is first contacted by the Department regarding examination of the return), and (ii) the applicable tax rates under IITA § 201.

In general, IITA § 1005(c) applies to taxable years ending on and after December 31, 2004. However, under a special rule the penalty may be applied to any deficiency attributable to a listed transaction entered into after February 28, 2000 and before December 31, 2004.

The federal American Jobs Creations Act of 2004 (Jobs Act) repealed the registration rules under IRC § 6111. As a result, the concept of an IRC § 6111 tax shelter no longer exists. <u>This change in federal law, coupled with the fact that the special rule in IITA § 1005(c) for listed transactions applies only if the transaction is entered into after</u>

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February 28, 2000 and before December 31, 2004, means that the 100% interest penalty will not apply to transactions entered into after October 31, 2004, unless the transaction is a listed transaction entered into before December 31, 2004. Any non-listed transaction entered into after October 22, 2004 will not be an IRC § 6111 tax shelter, and therefore will not be a potential tax avoidance transaction under IITA § 1005(c). Similarly, any listed transaction entered into after December 31, 2004, will not be an IRC § 6111 tax shelter, nor will the special rule in IITA § 1005(c) apply.

For example, consider an underpayment in TYE 2010 due to a LILO (listed) transaction. If the LILO transaction was entered into in January 2004, then an IITA § 1005(c) interest penalty could be assessed on the underpayment due to the LILO transaction. However, if the LILO transaction was entered into in January 2005, the 1005(c) interest penalty could not be assessed. Further, if the 2010 underpayment was due to any other type of reportable transaction entered into after October 22, 2004, the 1005(c) interest penalty could not be assessed.

Due to the restrictions on when the interest penalty can be assessed, it is less likely to be applicable in current audits than the penalties under IITA §§ 1001(b) and 1005(b).

Example #17

Taxpayer entered into a LILO transaction in March 2003 that was reversed under federal audit in 2010. This led to underreported federal income for calendar years 2003 through 2010. Taxpayer was already under audit in Illinois for calendar years 2011 and 2012. The audit will need to be expanded to include 2003 through 2010. Apart from other penalties and interest, Taxpayer will be subject to the IITA § 1005(c) interest penalty on the underreported liability in 2003 through 2010. To illustrate, the following shows the figures for 2010 needed to calculate the base on which to compute the penalty interest, which is the same base as for the IITA § 1005(b) penalty:

IL-1120 Return	Original Return	Amended Return per Audit
Federal taxable income	10,000,000	17,500,000
Net subtraction modifications	(2,000,000)	(2,000,000)
Base Income	8,000,000	15,000,000
IL Factor	0.100	0.100
ILL Net Income	800,000	1,500,000
IL Tax Rate	0.073	0.073
Illinois tax	$58,400	$109,500

Just like the § 1005(b) underreporting penalty base, the §1005(c) penalty interest base is $51,100 ($109,500-$58,400). The penalty interest would be calculated from the due date of the underpayment through the IL-870 date, if the underreported tax is also

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proposed on the IL-870. If the IL-870 was to be issued on 8/11/15, then penalty interest would be calculated on $51,100 from 3/15/11 through 8/11/15, which equals $5,479.05. If a notice of deficiency or bill is issued, then the penalty interest would be calculated through the date of such notice.

B. PROMOTER PENALTIES

If the promoter fails to report, IITA §§ 1007 and 1008 penalties apply.

The first promoter penalty is IITA § 1007, which basically applies a $15,000 penalty to the promoter for a failure to disclose regarding a reportable transaction. When the failure to disclose regards a listed transaction, the penalty increases to $100,000. This applies both to registering the tax shelter and maintaining a list of investors.

Refer to IAC §§100.5080 and 100.5070 for more information.

The second promoter penalty is IITA § 1008, which couples to IRC § 6700 and assesses a penalty against the income the promoter receives from the client for the abusive transaction. The penalty is the greater of $10,000 or 50% of the gross income received from each client to whom the promoter organized, sold, made a statement, or somehow participated in the abusive transaction. For example, a promoter develops promotional materials such as a prospectus and other documents which explain the promotion, and those documents are used as the evidence supporting a penalty under IRC § 6700 for organizing and promoting an abusive tax shelter. The abusive tax shelter was marketed to 13 clients who paid the promoter $50,000 each. The IITA § 1008 could be assessed, which would be the greater of $10,000 or 50% of the gross income. Thus, the penalty would be 50% of $650,000, or $325,000.

Refer to IITA § 1008 and IRC § 6700 for more information.

Note that neither promoter penalty in IITA §§ 1007 and 1008 is eligible for reasonable cause consideration.

VI. VCP

Although the Voluntary Compliance Program (VCP) was temporary and ended in 2005, some of that information still provides useful illustration of ATAT penalty concepts and explanation of adjustments that may have been made in previous audits. It is possible that some audits will include periods where the taxpayer participated in VCP, so familiarity with the program will be useful to the auditor.

A. VOLUNTARY COMPLIANCE PROGRAM (VCP)

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The Voluntary Compliance Program (VCP) ran from October 15, 2004 to January 31, 2005, and applied to all tax liabilities under IITA § 201 attributable to the use of abusive tax shelter transactions for taxable years beginning before January 1, 2004. IAC § 100.9900 gives the requirements for taxpayers participating in the VCP. Under this regulation, participation in the VCP was made separately for each year. Therefore, a VCP-1 form had to be attached to each amended or original return filed under the VCP and postmarked by January 31, 2005. If the taxpayer did not file an original return because it had no tax due because of the ATAT, then the taxpayer had to attach an original return with their VCP-1 computed without regard to the ATAT. This would include any composite return(s) filed on behalf of partners and S-Corporation shareholders. Taxpayers were to send their amended returns and VCP-1 forms to P.O. Box 19029, Springfield, IL 62794-9029.

In order to participate in the VCP the taxpayer was required to select one of two options on the VCP-1:

- Option 1 – Without appeal rights
- Option 2 – With appeal rights (Includes separate box for IRS Review)

1. VCP-1, Filed Under Option 1

Under Option 1 the taxpayer could never get a refund of the taxes paid that were attributable to an “eligible liability”. This includes an estimated RAR payment where the taxpayer overestimated its tax liability from the RAR. However, under Option 1, refunds are permitted for taxes paid that are not attributable to the tax avoidance transaction. For example, if the taxpayer filed a VCP-1 under Option 1 along with an amended return increasing the amount of tax from $10,000 to $15,000 by reversing the effects of an abusive tax shelter, the taxpayer could never get a refund of the $5,000 that was paid on the amended return. However, the taxpayer still could receive a refund of the $10,000 paid on the original return assuming that the claim was filed within the statute of limitations and the taxpayer was not seeking an Amnesty refund.

In addition to the ATAT penalties, the Department agreed to waive all UPIA penalties (except the non-filing penalty) if the taxpayer chose Option 1 on their VCP-1 form. This represented a considerable savings to the taxpayer, especially for Amnesty periods where the UPIA penalties are doubled. However, in return for this benefit the taxpayer agreed to forgo any possible claims for refund. Therefore, there are no refunds permitted under Option 1 as they relate to an ATAT liability except for interest computation errors.

If the IRS or the courts later determine that the ATAT is legitimate and allowable, there is still no refund of the eligible liability under Option 1. If the IRS later reduces federal taxable income, thereby reducing Illinois taxable income as it relates to a payment for an “eligible liability” made under Option 1, then the auditor or the taxpayer will prepare

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amended returns to reflect the correct amount of federal taxable income, but the refund will be identified on the amended return or EDA-25 as non-refundable.

Note: Under Option 1 the taxpayer can receive refunds of adjustments unrelated to the ATAT eligible liability, as long as it was not a payment made under the former Amnesty program.

2. VCP-1 Filed Under Option 2

If the taxpayer chose Option 2 on their VCP-1 form, then the only penalties abated were the ATAT penalties, as long as the original or amended return qualified under the VCP, However, all applicable UPIA penalties will be assessed, including a doubling of the UPIA penalties for Amnesty years.

Under Option 2, all types of refunds were permitted assuming that claims were filed within normal statutes and the payments were not made under Amnesty. This includes claims for any tax, penalty and interest paid under the VCP. See the section below on RAR adjustments regarding statute dates.

Once the statute expires on a tax year, the taxpayer has one year from the date of payment to file a claim for refund. This presented a problem for taxpayers that were under IRS audit who wanted to participate in the VCP program and pay the tax in case the IRS disallowed their ATAT transaction. Since the IRS could take years to complete their audit, the taxpayer would not be able to get a refund of any overestimated taxes paid to Illinois since the claim would be filed more than one year after the payment of tax.

Therefore, on the VCP-1 form the taxpayer had the option to check the box entitled "IRS Review (option 2 only)". This was copied from California's version of the program. Under this option the taxpayer could file an Illinois amended return under the VCP based on an estimated change to federal income if they lost before the IRS. Checking the IRS Review box allowed the amended return (showing that they owe money) to also serve as a refund claim. This means that if the taxpayer prevailed over the IRS and did not owe anything, then they would not have to file a claim with Illinois to get the money back that was paid under the VCP. They would simply provide us with the IRS report showing that they owed no tax from the ATAT transaction and we could refund the money that they paid on the amended return. Since no amended return was required claiming an overpayment, the refund could be issued past the statute date for filing a claim.

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3. Computing The Eligible Liability

IAC § 100.9900(c) sets forth the requirements for participation in the VCP. In order to participate in the VCP, a taxpayer must have, within the VCP period, (i) filed Form VCP-1 along with an amended Illinois income tax return that reports Illinois net income for the taxable year computed without regard to any tax avoidance transactions, (ii) paid the full amount of the "Eligible Liability" (plus interest), and (iii) made the election to participate either with or without appeal. IAC § 100.9900(c)(1)(E) states that failure to correct an underreporting of tax that is not attributable to participation in a tax avoidance transaction shall not preclude relief under the VCP.

IAC § 100.9900(c)(2)(A) defines "Eligible Liability" to mean the excess, if any, of:

> (i) The Illinois tax liability for the taxable year properly computed without allowing the net tax benefits of any tax avoidance transactions, over
>
> (ii) The Illinois tax liability for the taxable year properly computed allowing the net tax benefits of any tax avoidance transactions in which the taxpayer participated.

The "properly computed" language means that we had to allow any offsets against the eligible liability that the taxpayer was entitled to at the time the original return was filed, such as offsets discovered either by the taxpayer or the auditor upon audit.

This included the following:

- INL carryovers from earlier years (but not INL carrybacks)
- Capital loss carrybacks as long as the capital loss is not ATAT related
- Credit carryovers from earlier years
- Net adjustments for the current year (taxpayer or audit adjustments)
- RAR adjustments

With respect to computation of the eligible liability, all proper non-ATAT adjustments had to be made to a taxpayer's return in computing both the tax liability allowing the net tax benefits of the ATAT and the tax liability without allowing the net tax benefits of the ATAT transaction. The following examples illustrate the computation of the eligible liability under IAC § 100.9900(b)(2) (for simplicity the examples disregard the standard exemption and any credits, uses the appropriate 3% individual tax rate, and in the case of corporations assume all items are business income and the tax rate is 10%).

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Example #18

Taxpayer, an Illinois resident, timely filed his original 2003 Illinois income tax return reporting federal adjusted gross income of $100, $0 addition modifications and $0 subtraction modifications, for Illinois base income of $100. Taxpayer reported and paid the resulting $3 of Illinois income tax. During the VCP period, Taxpayer filed an amended return reporting federal AGI of $200 (i.e. Taxpayer reversed a loss of $100 from an ATAT). Taxpayer paid the additional $3 of Illinois income tax along with the amended return. Upon review of Taxpayer's amended return, the Department discovered that Taxpayer failed to report a $50 addition modification.

The eligible liability is computed as the difference between Taxpayer's Illinois liability properly computed without allowing the net tax benefits of the ATAT and the Illinois liability properly computed allowing the net tax benefits of the ATAT:

IAC § 100.9900(b)(2)(A)(i) Without ATAT		IAC § 100.9900(b)(2)(A)(ii) With ATAT	
AGI	$200	AGI	$100
Add	$ 50	Add	$ 50
Sub	$ 0	Sub	$ 0
Base	$ 250	Base	$ 150
Tax	$7.50	Tax	$4.50

Thus, the eligible liability is $3. Because Taxpayer reported and paid the eligible liability, Taxpayer qualifies for VCP relief provided all other requirements are met. It does not matter that Taxpayer failed to report and pay the additional tax attributable to the addition modification. Nevertheless, Taxpayer remains liable for the additional tax attributable to the addition modification (a non-ATAT adjustment), including applicable penalties and interest. The Department will therefore issue a notice of deficiency for $1.50 additional tax, plus applicable penalties and interest.

Example #19

Same facts as in Example #18, except that Taxpayer's VCP amended return properly includes a $100 subtraction modification that was not claimed on his original return. As a result, Taxpayer's amended return continues to show only a $3 tax liability, and no additional payment is included with the amended return. The computation of the eligible liability is as follows:

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IAC § 100.9900(b)(2)(A)(i) Without ATAT		IAC § 100.9900(b)(2)(A)(ii) With ATAT	
AGI	$200	AGI	$100
Add	$ 50	Add	$ 50
Sub	$100	Sub	$100
Base	$150	Base	$ 50
Tax	$4.50	Tax	$1.50

The difference between the proper tax computed without and with the net tax benefits of the ATAT transaction, or $3 (i.e. $4.50 - $1.50), is the eligible liability. Because Taxpayer failed to make any additional payment upon filing the VCP return, he has not paid the entire amount of the eligible liability as required to participate in the VCP. The Department will issue a notice of deficiency for $1.50 (i.e. correct tax $4.50 less tax shown on return of $3), plus applicable penalties and interest.

Example #20

Taxpayer, a corporation, timely filed its original 2003 Illinois income tax return reporting federal taxable income of $300 and $0 in modifications. The apportionment factor reported on the return consists of $1,000 total sales, $500 of which is sourced to Illinois, for a 50% apportionment factor. Taxpayer reported the resulting $150 Illinois net income, and (assuming a 10% rate) paid the $15 tax. During the VCP period, Taxpayer filed an amended return that reports federal taxable income of $400 (i.e. taxpayer reversed a loss of $100 from an ATAT), $0 addition and $0 subtraction modifications, for Illinois base income of $400. Based on a 50% apportionment factor, the amended return shows Illinois net income of $200 and total tax of $20. Taxpayer paid the extra $5 tax (i.e. $20 – $15) with the amended return. Upon review of Taxpayer's amended return, the Department discovered that Taxpayer failed to source to Illinois $250 of gross receipts. Taxpayer's properly computed apportionment factor is 75% (i.e. 750/1000) rather than 50% (i.e. 500/1000).

The eligible liability is computed as the difference between Taxpayer's Illinois liability properly computed without allowing the net tax benefits of the ATAT and the Illinois liability properly computed allowing the net tax benefits of the ATAT:

IAC § 100.9900(b)(2)(A)(i) Without ATAT		IAC § 100.9900(b)(2)(A)(ii) With ATAT	
FTI	$400	FTI	$300
Add	$ 0	Add	$ 0

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Sub	$ 0	Sub	$ 0
Base	$400	Base	$300
Factor	75%	Factor	75%
NI	$300	NI	$225
Tax	$ 30	Tax	$22.50

Thus, the eligible liability is $7.50. Because Taxpayer did not report and pay the entire amount of the eligible liability (only $5 of the eligible liability was paid), it does not qualify for VCP relief. The Department will issue a notice of deficiency in the amount of $10 (i.e. correct tax of $30 less tax shown on return of $20), plus applicable penalties and interest.

Example #21

Same facts as in Example #18, except that Taxpayer's VCP amended return properly includes a $100 subtraction modification that was not claimed on its original return. Therefore, Taxpayer's amended return continues to show only a $15 tax liability, and no additional payment is included with the amended return. The eligible liability is computed as follows:

IAC § 100.9900(b)(2)(A)(i) Without ATAT		IAC § 100.9900(b)(2)(A)(ii) With ATAT	
FTI	$400	FTI	$300
Add	$ 0	Add	$ 0
Sub	$(100)	Sub	$(100)
Base	$300	Base	$200
Factor	75%	Factor	75%
NI	$225	NI	$150
Tax	$22.50	Tax	$ 15

The eligible liability is equal to the difference between the tax properly computed without the tax benefits of the ATAT and the tax properly computed allowing the ATAT, here $7.50. Because Taxpayer failed to include any additional payment along with the VCP return, it has not paid the entire amount of the eligible liability as required to participate in the VCP. The Department will issue a notice of deficiency for $7.50, plus applicable penalties and interest.

The taxpayer is required to compute the tax as "properly computed" based on the last filed amended return. Therefore, if the taxpayer has been previously audited, then the taxpayer must have used in Column A of its amended return the previously adjusted figures even if those adjustments were unagreed. This would include what the Department determined to be the correct apportionment factor from an unagreed audit.

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Since reversal of the ATAT increases federal taxable income, any difference in the apportionment factor will directly affect the eligible liability that is paid under the VCP.

Example #22

The Department audited XYZ Corporation for 2001 and determined that the apportionment factor should be higher. Taxpayer disagreed with the audit results and protested the audit liability. Later, the taxpayer filed an amended return and VCP-1 under Option #2 and checked the box for IRS Review. The amended return reversed the tax effect of a listed transaction. However, Taxpayer used the original apportionment factor. Assuming that Taxpayer lost in court on the apportionment issue, it will have underpaid its eligible liability, and will be subject to ATAT penalties under IITA § 1005(b) and (c), assuming that the listed transaction was entered into on or after February 28, 2000. The ATAT penalties will have to be assessed by the auditor using the apportionment factor as previously audited.

Example #23

The auditor reviewed an IL1120-X reporting an ATAT and determined that Taxpayer made two adjustments to the amended return in addition to reversing the ATAT. On the original return as filed Taxpayer reported $1,000,000 in federal taxable income, an Illinois factor of 25% and had paid tax of $18,250. On January 31, 2005 Taxpayer filed a VCP-1 along with an IL-1120-X to report a $2,000,000 increase to federal taxable income due to a listed transaction, claim a capital loss carryback of $500,000 (non-ATAT related), and claim nonbusiness income everywhere of $500,000. Taxpayer paid additional tax of $18,250 plus estimated interest on the amended return.

The auditor was required to perfect the amended return and process it first. This made Column A of the EDA-25 Column C of the amended return. The auditor next determined that only $250,000 of the nonbusiness income was allowable and that the Illinois factor should be 50% instead of 25%. Neither adjustment was ATAT related.

For purposes of determining the Eligible Liability, all proper non-ATAT adjustments must have been made to a taxpayer's return in computing both the tax liability allowing the net tax benefits of the ATAT and the tax liability without allowing the net tax benefits of the ATAT transaction. Accordingly, the Eligible Liability is computed as follows:

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IAC § 100.9900(b)(2)(A)(i) Without ATAT		IAC § 100.9900(b)(2)(A)(ii) With ATAT	
FTI*	$2,500,000	FTI	$500,000
Add	0	Add	0
Sub	0	Sub	0
Base	$2,500,000	Base	$500,000
NB	(250,000)	NB	(250,000)
BI	$2,250,000	BI	$250,000
Factor	50%	Factor	50%
NI	$1,125,000	NI	$125,000
Tax rate	.073	Tax rate	.073
Tax	$ 82,125	Tax	$ 9,125
Credits	0	Credits	0
Tax liability	$ 82,125	Tax liability	$ 9,125

Note: Federal taxable income in each case takes into account the $500,000 capital loss carryback. Thus, FTI in the "Without ATAT" computation is: $3,000,000 - $500,000 = $2,500,000; and in the "With ATAT" computation is $1,000,000 - $500,000 = $500,000.

The Eligible Liability is the difference between the Illinois tax liability computed without the ATAT items and the Illinois tax liability computed with the ATAT items. In the above example, that difference is $73,000 (i.e. $82,125 – $9,125). Taxpayer did not qualify for the VCP because it only paid $18,250.

4. Statute Dates on VCP Amended Returns

IITA § 905(e) deals with limitations on issuing notices of deficiency for reported federal changes. IITA § 905(e)(2) provides that, "in any case where notification of an alteration is given as required by 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 …" Therefore, if the taxpayer owes additional tax as a result of notification of a federal change required under IITA § 506(b), then we have two years from the date of the amended return to issue a notice of deficiency for additional tax, but we have three years to issue a notice and demand for admitted penalty and interest.

For more information on deemed assessed liabilities refer to the sections on "Deemed Assessed" and "Proposed Assessment/Liability" in Chapter 21 of the Audit Manual.

State changes will fall under IITA § 903(a), which provides that the amount of tax, which is shown to be due on the return, including an amended return showing an increase in tax, shall be deemed assessed on the date of filing the return. IITA § 1003(b) states that

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interest prescribed under such section on any tax shall be deemed assessed upon the assessment of the tax or penalties to which such interest relates and shall be collected and paid on notice and demand in the same manner as tax. IITA § 902(a) provides that in the case of tax deemed assessed upon the filing of a return, the Department must issue a notice and demand for payment no later than three years after the date the "return" was filed.

5. VCP-1 – Amended Return Reporting a Liability – Listed Transaction

This section assumes that the taxpayer paid all of the eligible liability including tax and estimated interest shown on an amended return, that the VCP-1 has been completed properly (or the auditor was able to perfect the VCP-1) and filed by January 31, 2005, and that the taxpayer reported a "listed transaction" that falls under one of the categories on the IRS website.

If the taxpayer filed the VCP-1, the auditor had to compute the eligible liability to determine that the taxpayer qualified for VCP. Under Option 2, the taxpayers owed UPIA penalties on the liability whether or not they qualified for the VCP. No ATAT penalties would be due whether or not Option 1 or Option 2 was selected if the taxpayers properly computed and paid all of the eligible liability with interest.

Under Option 1, if the taxpayer did not pay all of the eligible liability, then the taxpayer was disqualified from the VCP, UPIA penalties will be applicable, and those amounts will be doubled if it is for a UPIA tax period eligible for 2003 Amnesty .

The ATAT adjustments as well as all other adjustments should be included in the audit workpapers and transferred to the EDA-25. Whether the amended return was processed or not, the figures in Column A of the EDA-25 should come from Column C of the amended return. If Column A of the amended return did not match BIT, then the auditor would have to correct the amended return using the procedures discussed in Chapter 20 of the Audit Manual under the section "EDA-25". .

The audit was to be completed in the normal manner. Under exchange agreements the Department is required to share the results of the audit with other states as well as the IRS.

As is often the case on tax shelters, there may be multiple taxpayers involved. The auditor is responsible for auditing all of the taxpayers that pertain to the ATAT. Each Illinois filer will require a separate track. The auditor will include comments in the Auditor's Comments stating what action was taken on the other tracks.

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6. UPIA Penalties

The Voluntary Compliance Program dId not affect the computation of any applicable UPIA penalties, and those penalties were still doubled if it was for an Amnesty year. The only thing that VCP did was abate the UPIA penalties, except for the non-filing penalty, if the taxpayer chose Option 1 on the VCP-1 and the taxpayer met all of the VCP requirements.

Under IAC § 100.9900(c)(2), the taxpayer was required to pay the full amount of the eligible liability plus interest. This includes a doubling of the interest and UPIA penalties for periods covered under the former Amnesty program. IAC § 100.9900(c)(2)(C) required that the taxpayer make a "good faith attempt" to compute the correct amount of eligible liability including penalty and interest and pay that amount during VCP. The taxpayer then had 30 days to pay any additional eligible liability plus penalty and interest when billed.

Audit requires that taxpayers file amended returns whenever they have a finalized RAR. If the EDA-24, EDA-25 or amended return includes an RAR, then it must have a schedule attached showing the tax effect of just the ATAT liability.

Under the first Amnesty program the taxpayer could make a payment within the Amnesty period without filing an amended return, and then that payment would qualify for Amnesty. However, that was not the case with the VCP program. Auditors cannot adjust for RARs (overpayments or underpayments) where the RAR has not yet been finalized. In order to participate in VCP, the taxpayer had to file a VCP-1, an amended return, and pay the tax due with estimated interest that was attributable to the abusive tax shelter. However, under the VCP taxpayers could estimate what they owed on an RAR and file an estimated Illinois amended return with the VCP-1 choosing Option 2, but if they chose Option 1 without appeal, they would not be entitled to a refund of any overestimated tax.

If the taxpayer made a valid VCP filing, then the taxpayer could receive a refund of an estimated RAR payment under Option 2 as long as the claim was filed within statute as noted below. Under Option 1, there was no refund.

If the taxpayer filed an estimated tax payment with or without an amended Illinois return and later wanted a refund or partial refund of that tax, the first thing that the auditor had to do was check to see that the claim was within statute. Under IITA § 911(b)(1), the taxpayer has two years to file a claim for refund for a federal change which starts at the time federal notification was due by means of an amended federal return or a completed federal RAR. If there was no federal amended return due or filed, and no completed federal RAR or final determination, then this two-year, 120-day federal change statute in IITA § 911(b) did not apply. If the normal statute of limitations period

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on the year expired and there was no waiver to extend the statute of limitations on an IL-872, then the statute date under IITA § 911(a)(1) was one year from the date that payment was made. The statute dates on refund claims was explained in FY Bulletin 2005-10.

Example #24

A partnership filed its 1999 IL-1065 timely and paid $10,000 in replacement tax. Realizing that the partners were under IRS audit, the partnership made an estimated payment under Amnesty on November 13, 2003, for $200,000. The IRS completed an audit on the partners and reversed the tax effects of a Son of Boss transaction in which it determined that the tax attributes of the transaction affecting the partnership were "disregarded". This had the effect of creating large income for the partners, but the partnership itself ended up with zero federal income. On December 4, 2004, the partnership filed an IL-843 to claim a refund of the original $10,000 payment as well as the November 13, 2003 Amnesty payment of $200,000. Since there was no amended federal Form 1065 filed at the time the Amnesty payment was made, the taxpayer can only receive a refund of their original $10,000 payment since it is within 2 years and 120 days of the federal finalization date. The statute date on the $200,000 Amnesty payment expired November 13, 2004. In this situation, the auditor would prepare an amended IL-843 along with an amended IL-1065 to reflect the correct federal taxable income of zero. The auditor would have then marked the Amnesty payment portion of the claim as out-of-statute.

7. Processing Problems with VCP Amended Returns

If there were problems with the amended returns filed where the taxpayer had an admitted liability, then the auditor had to correct the original amended return. We could not get revised amended returns to correct the taxpayer's original changes without potentially creating a problem with the interest computation. The taxpayer's amended returns needed to be processed in the order in which they were received. If Column A of the first amended return did not match Gentax, but the tax was correct on the amended return, then the auditor should have perfected the amended return by transferring the amounts from the amended return onto an EDA-25 for processing. No IL-870 was needed if the tax was correct on the amended return.

If there were problems with the original amended return and there was tax due or overpaid from what the taxpayer's amended return showed, then it was necessary to get an EDA-24, EDA-25 with IL-870, or a new amended return showing only the difference from what was originally reported on the amended return. Then, the taxpayer's original amended return would still be processed. An IL-870 showing only the tax increase must have been signed by the taxpayer within statute or a notice of deficiency must have been issued within statute.

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IAC § 100.9900(c)(2) states that in order to qualify for the VCP taxpayers must have paid the full amount of the "eligible liability" during the VCP period that ended January 31, 2005. If there was a balance due from adjusting the amended return, and the auditor determined that it was additional tax due on the "eligible liability", then the taxpayer would have been disqualified from the VCP for that particular year.

For example, the taxpayer underreported a capital gain from an ATAT that should have been included in the sales factor. If the taxpayer reversed the tax effect of the ATAT by including the proper gain in Illinois base income, but then did not include the gain in the Illinois sales factor (if it was an Illinois gain), then the taxpayer would have been underreported on its "eligible liability" and may have been disqualified from the VCP for that particular year.

Another example would be where the Department increased the sales factor in a prior, unagreed audit but the taxpayer used the original Illinois factor for its Column C on the amended return. In that case the eligible liability was understated.

8. Offsets

To participate in the VCP, taxpayers were supposed to report their correct liability without claiming any benefits for tax shelters. This allowed taxpayers to make any changes to the returns needed to arrive at the correct liability that included claiming credits and subtraction modifications not claimed on the original return. This allowed the taxpayers to mitigate the effects of their abusive tax shelter liability by claiming tax credits, making factor changes, claiming nonbusiness income, claiming capital loss carrybacks, etc., that were not claimed previously.

Consequently, there was no legal requirement for taxpayers to file two amended returns to reverse the effects of the tax shelter and to claim other adjustments. They could comply with the VCP requirements by filing one amended return for each year as long as the taxpayers explained what they were doing and realized that there would be restricted interest (and that they had to pay the interest when billed). A pro forma amended return computing the tax due without the abusive tax shelter could be attached to the amended return, or the taxpayers could attach a worksheet to the amended return showing the tax due from the tax shelter.

If the taxpayer filed a claim for credit for non-ATAT related liabilities, then it did not matter which option the taxpayer chose under VCP to get a refund of non-ATAT related adjustments, as long the claim was within statute and it was not an Amnesty payment. If the taxpayer also wanted a refund of the "eligible liability", then the VCP-1 had to have been filed using Option 2. It was the "eligible liability" only that could not be refunded under Option 1. If the taxpayer filed a claim for credit after the VCP period

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ended, and the taxpayer chose Option 1, then the auditor had to determine the portion, if any, of the claim related to the "eligible liability" which is defined in IAC § 100.9900(b)(2)(A) as the excess of:

(i) the Illinois income tax liability for a taxable year properly computed without allowing the net tax benefits of any tax avoidance transaction, over

(ii) the Illinois income tax liability for that taxable year properly computed allowing the tax benefits of any tax avoidance transactions in which the taxpayer participated.

Example #25

The taxpayer filed its original 2002 IL-1120 and reported a tax liability of $10,000. The taxpayer later filed a VCP-1 under Option 1 along with an amended return on January 31, 2005 reporting an additional $10,000 in tax from reversing the tax effects of a Son of Boss transaction. However, this was offset by $2,000 in investment credits that the taxpayer did not report on its original return. The taxpayer paid $8,000 with the amended return. After the VCP period ended, the taxpayer filed an amended return where the IRS allowed the transaction which caused an Illinois refund of $15,000. The taxpayer could not receive a refund of the "eligible liability" which is the difference between the tax properly due for the period without the ATAT or $18,000, and the proper amount of tax due with the ATAT which is $8,000 (the original $10,000 minus the $2,000 additional tax credit). The eligible liability was $10,000 ($18,000 – $8,000) which would be non-refundable. The auditor would prepare the EDA-25 or IL-1120-X allowing the capital loss carryback in full, but would mark on the amended return that $10,000 of the claim was non-refundable.

If the taxpayer selected Option 2, then an overpayment on one amended return could be used to offset the tax due on an underpaid amended return as long as the taxpayer received permission from the Department to make the offset. If the taxpayer selected Option 1, then no offsets would be permitted. This would be a problem where taxpayers sent in VCP-1s for multiple years with just a letter attached stating that they wanted an offset between the periods. Unless the taxpayer received permission from the Department, which could be verbal permission from an auditor, then there would be no offset against the liability unless the Board of Appeals granted the offset.

9. VCP-1 – Amended Return Shows an Overpayment

If there were problems processing an amended return that showed an overpayment, then the procedures in Chapter 21 of the Audit Manual should be followed regarding multiple EDA-25s or amended returns. In cases where the auditor was making changes to an unprocessed IL-1120-X, the first EDA-25 or IL-1120-X had to match the

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BIT history. If column A of the first amended return did not match BIT, then the auditor would prepare an EDA-25 to correct Column A so that the return would process. The auditor then prepared a second EDA-25 or IL-1120-X in order to make the audit adjustments for the differences. An audit involving an IL-1120-X claiming an overpayment was coded OC or OC/CR.

Although the overall effect of an ATAT is to reduce federal and state income taxes over a period of time, reversing the tax effects of an ATAT often results in an overpayment in one year. If the taxpayer is overpaid from reversing the effects of an ATAT, the taxpayer will be entitled to a refund for that year, except for Amnesty payments*. If the taxpayer attached the VCP-1 to a group of amended returns reversing an ATAT, and one of those amended returns is an overpayment, then a refund will be issued on the overpaid year regardless of whether or not the taxpayer chose Option 1 or Option 2. This is because on an amended return showing an overpayment, there is no “eligible liability”. Under Option 1, it is the eligible liability that is not refundable.

If the taxpayer submitted a letter requesting that the overpayment on one amended return be used to offset the tax due for other periods, then the Department must have acted on that request for offset, in writing, prior to the time that the VCP period ended on January 31, 2005. Otherwise, the taxpayer would be billed for any deficiencies for the underpaid years, but would be issued a refund for the tax plus interest on the overpaid year. If the offset is permitted, then the offset will be made tax to tax, prior to any interest or penalty computation.

*Note: There are only two situations where the Department will refund tax in a year in which an Amnesty payment was made. Refer to Audit Manual Chapter 2 for information on the Amnesty Programs.

Unless extended by waiver, the taxpayer must file an amended return to claim a refund within:

- Three years after the due date of the return (including extensions),
- Three years after the date the original return was filed, or
- One year after the date the Illinois tax was paid, whichever is later.

Even if the normal statute of limitations is open or an auditor has a waiver to extend the statute, a claim for refund from an RAR must be filed within two years after the date that notification was required under IITA § 506(b), which makes it two years and 120 days from the RAR finalization date.

Note: Audit Manual Chapter 21 requires the taxpayer to report the RAR on an amended return. The auditor should not accept RAR workpapers in the absence of an amended return.

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If the taxpayer made an estimated payment based on an RAR that was not finalized and the finalized RAR results in an overpayment of the estimated payment, then the statute date is one year after the date of payment unless the auditor extended this one-year statute on an IL-872.

Under VCP Options 1 and 2, taxpayers could receive a refund of interest that was overpaid due to computational errors that were attributable to an abusive tax shelter liability reported under VCP.

If the IRS finalizes an audit that reduces tax in a year in which an Amnesty payment was made, any overpaid Illinois Income Tax could be refunded for that year.

If the finalized audit increased or created a federal net operating loss (FNOL) or an Illinois net loss (INL), the loss could be carried according to the rules set for in the IITA and used to offset taxable income in the year or years to which it was carried, regardless of whether or not an Amnesty payment was made in the year to which the loss was carried.

If a taxpayer was under audit and estimated the audit liability because the audit could not be completed prior to the close of Amnesty, a refund of any overestimated "Amnesty" tax paid as well as any other payments made in the year could be issued. However, the taxpayer MUST have agreed to the audit findings in order for the refund to be issued. No amended return should have been filed for the refund amount because the taxpayer must have signed an IL-870 agreeing to the audit findings. If the taxpayer failed to sign the IL-870 and agree to the audit findings, no refund would be issued. The taxpayer must have then protested the audit findings.

10. Carrying Losses under the VCP

Other than the restriction against the taxpayer receiving a refund under Option 1 of the eligible liability discussed below, the VCP program did not, by itself, have any effect on the carrying of Illinois net losses or federal capital losses. The limitations on changing Illinois net losses under IITA §§ 905(n) and 911(h) apply for loss years ending prior to December 31, 2002.

Reversing the tax effects of an ATAT can cause an INL, or increase an INL in a year that the taxpayer will want to carry to another year. However, many amended returns filed under the VCP contained estimated tax effects of future RAR changes that had not yet been finalized. If the taxpayer was carrying a capital loss, or an Illinois net loss, the taxpayer must have filed an amended federal return that caused a capital loss or the INL in the loss year. Illinois cannot process changes to federal taxable income without an amended federal return that has been filed and accepted by the IRS, or a final determination by the IRS or courts. Under the first Amnesty program, the taxpayer could make a payment without an amended return and apply it towards Amnesty, but

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this was not the case under the VCP. If the taxpayer was carrying a capital loss, or an Illinois net loss, the auditor had to verify that the IRS accepted the amended federal return that created the Illinois loss.

If the taxpayer filed an amended return, along with a VCP-1 where **"Option 1"** was selected for a carry year, then the taxpayer would not be able to receive a refund of the "eligible liability" from the carrying of a capital loss or INL to that year. This included RAR changes that caused or increased a loss in the loss year. If the taxpayer filed the VCP-1 in the carry year under Option 1, then the auditor possibly had to prepare three EDA-25s or IL-1120-Xs for the carry year:

- The first EDA-25 would show the eligible liability from reversing the effects of the ATAT.
- The second EDA-25 would show the other audit adjustments not including the loss carryback.
- The third EDA-25 would show the carryback of the capital loss, or Illinois net loss, and no refund would be permitted of the eligible liability.

When the taxpayer was carrying back a capital loss to a year where the VCP-1 was filed under Option 1 and the refund exceeded the eligible liability, then the auditor needed to mark the excess as "non-refundable – VCP-1 filed under Option 1".

11. No VCP Filing – Amended Return Showing An ATAT– Tax Due

This was for situations where the taxpayer submitted an amended return where there was no VCP filing. The auditor would need to determine what ATAT adjustments were made and whether or not that change was one of the "listed transactions" per the IRS web site. If it was not a listed transaction, and it was a tax period ending prior to December 31, 2004, then the audit could be completed in the normal manner.

If the ATAT reported on the amended return was for a reportable transaction for tax years ending on or after December 31, 2004, or if it was for a "listed transaction" entered into after February 28, 2000, regardless of the year-end, then the auditor would need to determine the tax effect of reversing the ATAT apart from any other adjustments that were reported on the amended return, for purposes of computing the new ATAT penalties.

The audit would be completed in the normal manner.

See the sections "ILLINOIS DISCLOSURE REQUIREMENTS" and "ATAT PENALTIES AND INTEREST" in this chapter for more information.

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12. VCP Involving Composite Returns

IAC § 100.9900(c)(1)(C) permitted partnerships and Subchapter S corporations to file composite returns (IL-1023-C) under the VCP. This would include individuals not on the original composite return, if they could be included on a composite return under IAC § 100.5100 without asking for Department permission or if they had received permission.

However, if the composite return filer chose not to participate in the VCP, Legal Services determined that a nonresident individual who had been included in an original composite return could still file under the VCP. The taxpayer in this circumstance would file his own IL-1040-X. Still, the taxpayer had to indicate what his liability was and how much was paid on his behalf on the composite return, and then fully explain and document his or her calculations.

13. Unprocessable Returns

If the taxpayer has filed an unprocessable return, then IAC § 100.9900(c)(1)(D) states, in part:

> ... An unprocessable return filed during the Voluntary Compliance Program Period will qualify for relief under this Section only if a processable return is filed within 30 days after the Department has issued a notice to that taxpayer that the return filed was unprocessable.

In order to determine if the taxpayer has filed a processable return, the Department will use the definition of a processable return in UPIA § 3-2(d), which states in part:

> ...it must be in the form prescribed or approved by the Department, signed by the person authorized by law, and contain all information, schedules, and support documents necessary to determine the tax due and to make allocations of tax as prescribed by law.

As stated above, the taxpayer had 30 days to perfect an unprocessable return. The 30 days began when the Department issued the taxpayer a notice stating that the return was unprocessable. This would include a letter from an auditor stating that the return is unprocessable. If the auditor had amended returns in his possession that had not been processed, then the auditor should have reviewed those returns to make sure that they were processable. If not, then the auditor should have notified the taxpayer that the returns needed to be signed, the proper supporting schedules needed to be attached, or whatever else was needed to make the return processable. The auditor **must have** followed up on these requests made to the taxpayer. If the taxpayer failed to respond

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to the auditor's request in a timely manner, then the taxpayer was disqualified from the VCP for that year and could be subject to penalties.

As long as a taxpayer filed an amended return within the VCP period indicating that the return was for the reversal of a tax avoidance transaction, and attached a properly completed VCP-1 along with full payment of the eligible liability, then the taxpayer would qualify for the VCP. In that case, the auditor would be allowed to correct the taxpayer's amended return in order to process it.

14. VCP-1 Filed Without Amended Returns

When the VCP began, the Department mailed thousands of information letters and brochures to taxpayers along with the VCP-1. However, many taxpayers used the VCP-1 as a means of informing the Department that they were not involved in any tax shelter. This was not an intended use of the form. In many cases, a letter was sent (identified in small print at the bottom as VCP-2) in which we notified the taxpayer that we had information from the IRS or other states that the taxpayer had participated in an ATAT. These referrals were based on audits on the ATATs themselves where Illinois was notified that certain participants might have participated in an ATAT.

If there were no amended returns filed with the VCP-1, then the taxpayers should have been notified in writing that they did not comply with the VCP rules and therefore were not entitled to any relief under the VCP. The Department had an obligation to verify taxpayers' claims that they did not participate in a tax shelter, however what action the Department would take was done on a case-by-case basis. Generally, the Department would not be auditing the following accounts:

- [redacted]
- [redacted]

If there was evidence of IRS activity on these cases, then we would wait until the RAR was received. If the taxpayer estimated the Illinois tax effect of the RAR and filed amended Illinois returns from an RAR that was not finalized, then we would process the amended returns. If the taxpayer underestimated the tax due and did not pay 100% of the liability under the VCP by January 31, 2005, then the taxpayer would be disqualified from the VCP and any applicable penalties would be due.

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In addition to the UPIA penalties, the auditor had to determine what ATAT penalties, if any, applied. Since there were nor are regulations on how to compute the ATAT penalties, the penalties had to be imposed based on the language in the statute.

15. Amended Returns Filed Under VCP

The last sentence of IITA § 501(b) allows an exception to the disclosure requirement for transactions entered into after February 28, 2000 and before January 1, 2005 where:

> (i) the taxpayer filed an amended Illinois income tax return which reverses the tax benefits of the potential tax avoidance transaction, or
> (ii) as a result of a federal audit the IRS has determined the tax treatment of the transaction and an Illinois amended return has been filed to reflect that treatment.

In order to come within this exception the Illinois amended return must have been filed prior to the time disclosure was otherwise due. This includes amended returns filed timely under VCP. IAC § 100.9900(e)(3)(B) states:

> Because the Voluntary Compliance Program Period will expire before the date the first disclosure of participation in a reportable transaction could be due under IITA § 501(b), filing of an amended return during the Voluntary Compliance Program Period reversing the tax benefits of a reportable transaction will avoid penalty under IITA § 1001(b) for failure to disclose a reportable transaction.

Therefore, there cannot be any IITA § 1001(b) penalty on transactions properly reversed under VCP.

Example #26

The taxpayer filed an amended return under the VCP for calendar year 2002 to reverse the tax effects of a listed transaction and paid additional tax due from the ATAT. However, the amended return and VCP-1 were filed on February 20, 2005, or twenty days after the VCP period that ended on January 31, 2005. Although the amended return properly computed the tax due from reversal of the ATAT, the auditor disqualifies the taxpayer from the VCP because the filing was late and assesses the IITA § 1005(b) ATAT reportable transaction penalty. Although the taxpayer did not qualify for the VCP, there is no IITA § 1001(b) penalty in this case. Under IITA § 501(b) disclosure was required by the due date of the first return due on or after July 30, 2004 (in this case the calendar year 2004 return). The amended return was filed by March 15, the due date of the 2004 return without extensions.

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VII. EXHIBITS

The IRS website provides useful information regarding abusive tax shelters and transactions, which can be found under the following link:

https://www.irs.gov/businesses/corporations/abusive-tax-shelters-and-transactions

That webpage would be helpful in conducting initial research into any audit ATAT issues. The first three exhibits in this section come from the IRS website and provide lists for they following types of reportable transactions: listed transactions, loss transactions, and transactions of interest.

The final exhibit is our Information Document Request (IDR) regarding tax avoidance transactions, the EDA-130.

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A. LISTED TRANSACTIONS

The following IRS list can be linked to at the following link:

https://www.irs.gov/businesses/corporations/listed-transactions

Recognized Abusive and Listed Transactions

Listed Transactions in Chronological Order

1. Revenue Ruling 90-105 – Certain Accelerated Deductions for Contributions to a Qualified Cash or Deferred Arrangement or Matching Contributions to a Defined Contribution Plan
2. Notice 95-34 - Voluntary Employee Beneficiary Association
3. ASA Investering Partnership v. Commissioner -Transactions similar to that described in the ASA Investering litigation and in ACM Partnership v. Commissioner
4. Treasury Regulation § 1.643(a)-8 – Certain Distributions from Charitable Remainder Trusts
5. Notice 99-59 - Corporate Distributions of Encumbered Property (BOSS)
6. Step-Down Step Down Preferred/Fast Pay Stock §1.7701(1)-3
7. Revenue Ruling 2000-12 – Debt Straddles
8. Notice 2000-44 – Inflated Partnership Basis Transactions (Son of Boss)
9. Notice 2000-60 Stock Compensation Stock Compensation Transactions
10. Notice 2000-61 – Guam Trust
11. Notice 2001-16 – Intermediary Transactions
12. Notice 2001-17 - §351 Contingent Liability
13. Notice 2001- 45 - §302 Basis-Shifting Transactions
14. Notice 2002-21 - Inflated Basis "CARDS" Transactions
15. Notice 2002-35 - Notional Principal Contracts
16. Common Trust Fund Straddles (Notice 2003-54), Pass-Through Entity Straddle (Notice 2002-50), and S Corporation Tax Shelter Transaction (Notice 2002-65)
17. Revenue Ruling 2002-69 - Lease In / Lease Out or LILO Transactions
18. Revenue Ruling 2003-6 - Abuses Associated with S Corp ESOPs
19. Notice 2003-22 - Offshore Deferred Compensation Arrangements
20. Notice 2003-24 - Certain Trust Arrangements Seeking to Qualify for Exception for Collectively Bargained Welfare Benefit Funds under § 419A(f)(5)
21. Notice 2003-47 - Transfers of Compensatory Stock Options to Related Persons
22. Notice 2003-55 - Accounting for Lease Strips and Other Stripping Transactions
23. Notice 2003-77 - Improper use of contested liability trusts to attempt to accelerate deductions for contested liabilities under IRC 461(f)
24. Notice 2003-81 - Major/Minor Tax Avoidance Using Offsetting Foreign currency Option Contracts
25. Notice 2004-8 - Abusive Roth IRA Transactions
26. Revenue Ruling 2004-4 - S Corporations ESOP
27. Revenue Ruling 2004-20 - Abusive Transactions Involving Insurance Policies in IRC 412(i) Retirement Plans
28. Notice 2004-20 - Abusive Foreign Tax Credit Transactions
29. Notice 2004-30 - S Corporation Tax Shelter Involving Shifting Income to Tax Exempt Organization
30. Notice 2004-31 - Intercompany Financing Through Partnerships
31. Notice 2005-13 - Sale-In Lease-Out transactions

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32. Notice 2007-57 - Loss Importation Transaction
33. Notice 2007-83 - Abusive Trust Arrangements Utilizing Cash Value Life Insurance Policies Purportedly to Provide Welfare Benefits
34. Notice 2008-34 - Distressed Asset Trust (DAT) Transaction
35. Notice 2015-73 - Basket Option Contracts
36. Notice 2017-10 - Syndicated Conservation Easement Transactions

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Revenue Ruling 90-105 **– Certain Accelerated Deductions for Contributions to a Qualified Cash or Deferred Arrangement or Matching Contributions to a Defined Contribution Plan** (transactions in which taxpayers claim deductions for contributions to a qualified cash or deferred arrangement or matching contributions to a defined contribution plan where the contributions are attributable to compensation earned by plan participants after the end of the taxable year (identified as "listed transactions" on February 28, 2000)). See also Rev. Rul. 2002-46, 2002-2 C.B. 117 (result is the same, and transactions are substantially similar, even though the contributions are designated as satisfying a liability established before the end of the taxable year), modified by Rev. Rul. 2002-73, 2002-2 C.B. 805

- Revenue Ruling 2002-46– §401k Accelerators
- Revenue Ruling 2002-73 - modifies RR 2002-46 for taxpayers electing to change method of accounting.

Voluntary Employee Beneficiary Association

Notice 95-34 **– Certain Trusts Purported to be Multiple Employer Welfare Funds Exempted from the Lists of §§ 419 and 419A** (certain trust arrangements purported to qualify as multiple employer welfare benefit funds exempt from the limits of §§ 419 and 419A of the Internal Revenue Code (identified as "listed transactions" on February 28, 2000)). See also § 1.419A(f)(6)-1 of the Income Tax Regulations (10 or more employer plans)).

ASA Investering Partnership v. Commissioner **-Transactions similar to that described in the ASA Investering litigation and in ACM Partnership v. Commissioner,** 157 F.3d 231 (3rd Cir. 1998) (transactions involving contingent installment sales of securities by partnerships in order to accelerate and allocate income to a tax-indifferent partner, such as a tax-exempt entity or foreign person, and to allocate later losses to another partner (identified as "listed transactions" on February 28, 2000)).

Treasury Regulation § 1.643(a)-8 **– Certain Distributions from Charitable Remainder Trusts** (transactions involving distributions described in § 1.643(a)-8 from charitable remainder trusts (identified as "listed transactions" on February 28, 2000)).

Corporate Distributions of Encumbered Property (BOSS)

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Notice 99-59 **– Transactions involving the distributions of encumbered property in which losses claimed for capital outlays have been recovered** (aka BOSS transactions) (transactions involving the distribution of encumbered property in which taxpayers claim tax losses for capital outlays that they have in fact recovered (identified as "listed transactions" on February 28, 2000)). See also § 1.301-1(g) of the Income Tax Regulations;

Step Down Preferred/Fast Pay Stock §1.7701(1)-3

Treasury Regulation § 1.7701(l)-3 **– Fast Pay or Step-Down Preferred Transactions** (transactions involving fast-pay arrangements as defined in § 1.7701(l)-3(b) (identified as "listed transactions" on February 28, 2000))

Revenue Ruling 2000-12 **– Debt Straddles** (certain transactions involving the acquisition of two debt instruments the values of which are expected to change significantly at about the same time in opposite directions (identified as "listed transactions" on February 28, 2000))

Notice 2000-44 **– Inflated Partnership Basis Transactions (Son of Boss)** (transactions generating losses resulting from artificially inflating the basis of partnership interests (identified as "listed transactions" on August 11, 2000)). See also § 1.752-6T of the temporary Income Tax Regulations and §§ 1.752-1(a) and 1.752-7 of the proposed Income Tax Regulations;

Son of Boss Settlement Initiative

- IRS Collects $3.2 Billion from Son of Boss
- Strong response to "Son of Boss" Settlement Initiative -- Over 1,500 taxpayers responded by the June 21 deadline to settle under Announcement 2004-46.
- IRS News Release Announcing Settlement Initiative
- IRS Fact Sheet, Son of Boss Settlement Initiative
- Announcement 2004-46, Son of Boss Settlement Initiative
- FAQs (updated 5-28-04 with eligibility information)
- Supplemental FAQs (11-1-04)
- Form 13582, Notice of Election to Participate in Settlement Initiative
- Form 13586, Additional Information and Documentation
- Form 13586-A, Settlement Initiative Declaration
- Initial RA Letter to Taxpayer
- Rejection Letter
- Closing Agreement Letter
- CCN 2003-20 - Chief Counsel Guidance

Stock Compensation Transactions

Notice 2000-60 **– Stock Compensation Transactions** (transactions involving the purchase of a parent corporation's stock by a subsidiary, a subsequent transfer of the purchased parent stock from the subsidiary

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to the parent's employees, and the eventual liquidation or sale of the subsidiary (identified as "listed transactions" on November 16, 2000));

Notice 2000-61 **– Guam Trust** (transactions purporting to apply § 935 to Guamanian trusts (identified as "listed transactions" on November 21, 2000));

Notice 2001-16 **– Intermediary Transactions** (transactions involving the use of an intermediary to sell the assets of a corporation (identified as "listed transactions" on January 18, 2001));

- Notice 2008-111 - (12/01/2008) – Clarifies Notice 2001-16 (2001-1 C.B. 730) that identified and described the intermediary transaction tax shelter as a listed transaction and supersedes Notice 2008-20 (2008-6 I.R.B. 406). The Notice defines an intermediary transaction in terms of its plan and of more objective components. Also, the Notice specifies when a person is engaged in a transaction as part of a plan and clarifies that a transaction may be an intermediary transaction for one person and not another.
- LB&I Industry Director Guidance - **Examination of Multiple Parties in Intermediary Transactions**

Notice 2001-17 **- §351 Contingent Liability** (transactions involving a loss on the sale of stock acquired in a purported § 351 transfer of a high basis asset to a corporation and the corporation's assumption of a liability that the transferor has not yet taken into account for federal income tax purposes (identified as "listed transactions" on January 18, 2001));

Notice 2001- 45 **– §302 Basis-Shifting Transactions** (certain redemptions of stock in transactions not subject to U.S. tax in which the basis of the redeemed stock is purported to shift to a U.S. taxpayer (identified as "listed transactions" on July 26, 2001));

Notice 2002-21 **– Inflated Basis "CARDS" Transactions** (transactions involving the use of a loan assumption agreement to inflate basis in assets acquired from another party to claim losses (identified as "listed transactions" on March 18, 2002));

- Appeals Settlement Guidelines (redacted)

Notice 2002-35 – **Notional Principal Contra**cts (transactions involving the use of a notional principal contract to claim current deductions for periodic payments made by a taxpayer while disregarding the accrual of a right to receive offsetting payments in the future (identified as "listed transactions" on May 6, 2002));

- Notice 2006-16, Tax Avoidance Using Notional Principal Contracts.
- Explanation of Notice 2006-16, Impact on Required Disclosures.

Common Trust Fund Straddles, Pass-Through Entity Straddle, and S Corporation Tax Shelter transaction

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Notice 2002-50– **Partnership Straddle Tax Shelter** (transactions involving the use of a straddle, a tiered partnership structure, a transitory partner, and the absence of a § 754 election to claim a permanent noneconomic loss (identified as "listed transactions" on June 25, 2002)); Notice 2002-65, 2002-2 C.B. 690 (transactions involving the use of a straddle, an S corporation or a partnership, and one or more transitory shareholders or partners to claim a loss while deferring an offsetting gain are substantially similar to transactions described in Notice 2002-50); and Notice 2003-54, 2003-33 I.R.B. 363 (transactions involving the use of economically offsetting positions, one or more tax indifferent parties, and the common trust fund accounting rules of § 584 to allow a taxpayer to claim a noneconomic loss are substantially similar to transactions described in Notice 2002-50 and Notice 2002-65);

- Notice 2003-54 - Common Trust Fund Straddle Tax Shelter
- Notice 2002-65– Passthrough Entity Straddle Tax Shelter

Revenue Ruling 2002-69, **Lease In / Lease Out or LILO Transactions** (transactions in which a taxpayer purports to lease property and then purports to immediately sublease it back to the lessor (often referred to as lease-in/lease-out; or LILO transactions) (identified as listed transactions on February 28, 2000)

- **LILO/SILO SETTLEMENT INITIATIVE** - On August 6, 2008, IRS Commissioner Douglas Shulman announced that settlements would be offered to taxpayers who participated in Lease-In/Lease-Out (LILO) and Sale-In/Sale-Out (SILO) transactions. IRS sent out letters giving taxpayers 30 days to make a decision on whether to accept the offer terms.
  - IRS Commissioner's Remarks 08-06-2008
  - LILO/SILO Initiative Frequently Asked Questions

Revenue Ruling 2003-6, **Abuses Associated with S Corp ESOPs** (certain arrangements involving the transfer of employee stock ownership plans (ESOPs) that hold stock in an S corporation for the purpose of claiming eligibility for the delayed effective date of § 409(p) (identified as "listed transactions" on December 17, 2002));

Notice 2003-22 - **Offshore Deferred Compensation Arrangements** (certain arrangements involving leasing companies that have been used to avoid or evade federal income and employment taxes (identified as "listed transactions" on April 4, 2003));

Notice 2003-24 - **Certain Trust Arrangements Seeking to Qualify for Exception for Collectively Bargained Welfare Benefit Funds under § 419A(f)(5)** (certain arrangements that purportedly qualify as collectively-bargained welfare benefit funds excepted from the account limits of §§ 419 and 419A (identified as "listed transactions" on April 11, 2003));

Transfers of Compensatory Stock Options to Related Persons

- Notice 2003-47 - **Transfers of Compensatory Stock Options to Related Persons** (transactions involving compensatory stock options and related persons to avoid or evade federal income and employment taxes (identified as "listed transactions" on July 1, 2003));

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- Announcement 2005-39 - Additional Guidance relating to Announcement 2005-19
- Announcement 2005-19 - Stock Option Settlement Initiative
- Stock Option Settlement Press Release
- Stock Option Settlement Fact Sheet
- Form 13656 - Settlement Election For Executives and Related Parties
- Form 13567 - Settlement Election for Corporations

Notice 2003-55 - Accounting for Lease Strips and Other Stripping Transactions (transactions in which one participant claims to realize rental or other income from property or service contracts and another participant claims the deductions related to that income (often referred to as "lease strips")), modifying and superseding Notice 95-53, 1995-2 C.B. 334 (identified as "listed transactions" on February 28, 2000);

- Notice 95-53 – Lease Strips - Modified and superseded by Notice 2003-55 above

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Notice 2003-77 - **Improper use of contested liability trusts to attempt to accelerate deductions for contested liabilities under IRC 461(f)** (certain transactions that use contested liability trusts improperly to accelerate deductions for contested liabilities under § 461(f) (identified as "listed transactions" on November 19, 2003)). See also § 1.461-2 of the Income Tax Regulations. See Rev. Proc. 2004-31, 2004-22 I.R.B. 986, for procedures which taxpayers must use to change their methods of accounting for deducting under § 461(f) amounts transferred to trusts in transactions described in Notice 2003-77.

- Lead Executive Memorandum -- Advises that settlements will not be offered on these issues
- Treasury News Release - Announcing Notice 2003-77
- TD 9095
- Regulation 136890-02
- Revenue Procedure 2004-31 - Change of accounting methods for improper contested liability trust transactions described in Notice 2003-77.
- Treasury News Release - Announcing Revenue Procedure 2004-31

Major/Minor Tax Avoidance Using Offsetting Foreign currency Option Contracts

Notice 2003-81 - **Offsetting Foreign Currency Option Contracts** (certain transactions in which a taxpayer claims a loss upon the assignment of a § 1256 contract to a charity but fails to report the recognition of gain when the taxpayer's obligation under an offsetting non-section 1256 contract terminates (identified as "listed transactions" on December 4, 2003));

Notice 2004-8 - **Abusive Roth IRA Transactions** (certain transactions designed to avoid the limitations on contributions to Roth IRAs described in § 408A (identified as "listed transactions" on December 31, 2003));

- Treasury Department News Release

S Corporations ESOP

Revenue Ruling 2004-04 - **Prohibited Allocations of Securities in an S Corporation** (transactions that involve segregating the business profits of an ESOP-owned S corporation in a qualified subchapter S subsidiary, so

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that rank-and-file employees do not benefit from participation in the ESOP (identified as "listed transactions" on January 23, 2004));

- Treasury Department Press Release

Revenue Ruling 2004-20 - **Abusive Transactions Involving Insurance Policies in IRC 412(i) Retirement Plans** (certain arrangements in which an employer deducts contributions to a qualified pension plan for premiums on life insurance contracts that provide for death benefits in excess of the participant's death benefit, where under the terms of the plan, the balance of the death benefit proceeds revert to the plan as a return on investment) (identified as "listed transactions" on February 13, 2004)). See also Rev. Rul. 2004-21, 2004-10 I.R.B. 544, §§ 1.79-1(d)(3), 1.83-3(e) and 1.402(a)-1(a)(1) and (2) of the proposed Income Tax Regulations, and Rev. Proc. 2004-16, 2004-10 I.R.B. 559;

- Revenue Ruling 2004-21
- Proposed Regulation 126967-03
- Revenue Procedure 2004-16
- News Release IR-2004-21

Notice 2004-20 - **Abusive Foreign Tax Credit Transactions** (transactions in which, pursuant to a prearranged plan, a domestic corporation purports to acquire stock in a foreign target corporation and to make an election under § 338 before selling all or substantially all of the target corporation's assets in a preplanned transaction that generates a taxable gain for foreign tax purposes (but not for U.S. tax purposes) (identified as "listed transactions" on February 17, 2004));

- Treasury Department Press Release
- Notice 2004-19 -- Withdraws
- Notice 98-5 and describes strategy to address abusive FTC transactions

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Notice 2004-30 - **S Corporation Tax Shelter Involving Shifting Income to Tax Exempt Organization** (transactions in which S corporation shareholders attempt to transfer the incidence of taxation on S corporation income by purportedly donating S corporation nonvoting stock to an exempt organization while retaining the economic benefits associated with that stock (identified as "listed transactions" on April 1, 2004));

- Lead Executive Memo regarding settlements (4/6/05)
- IRS Press Release 2004-44

Notice 2004-31 - **Intercompany Financing Through Partnerships** (transactions in which corporations claim inappropriate deductions for payments made through a partnership (identified as "listed transactions" on April 1, 2004)).

- Treasury Press Release dated 4/1/04

Notice 2005-13, **Sale-In Lease-Out transactions**

- Treasury Press Release

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- **LILO/SILO SETTLEMENT INITIATIVE**- On August 6, 2008, IRS Commissioner Douglas Shulman announced that settlements would be offered to taxpayers who participated in Lease-In/Lease-Out (LILO) and Sale-In/Sale-Out (SILO) transactions. IRS sent out letters giving taxpayers 30 days to make a decision on whether to accept the offer terms.
  - IRS Commissioner's Remarks 08-06-2008
  - LILO/SILO Initiative Frequently Asked Questions

Notice 2007-57 - **Loss Importation Transaction** (IRB 2007-29) (transactions in which a U.S. taxpayer uses offsetting positions with respect to foreign currency or other property for the purpose of importing a loss, but not the corresponding gain, in determining U.S. taxable income (identified as "listed transactions" on July 16, 2007)).

Notice 2007-83 - **Abusive Trust Arrangements Utilizing Cash Value Life Insurance Policies Purportedly to Provide Welfare Benefits** - 2007-45 I.R.B. 1 (transactions in which certain trust arrangements claiming to be welfare benefit funds and involving cash value life insurance policies that are being promoted to and used by taxpayers to improperly claim federal income and employment tax benefits (identified as "listed transactions" on October 17, 2007)).

Notice 2008-34 - **Distressed Asset Trust (DAT) Transaction** - 2008-12 I.R.B. 1 (transactions in which a tax indifferent party, directly or indirectly, contributes one or more distressed assets (for example, a creditor's interests in debt) with a high basis and low fair market value to a trust or series of trusts and sub-trusts, and a U.S. taxpayer acquires an interest in the trust (and/or series of trusts and/or sub-trusts) for the purpose of shifting a built-in loss from the tax indifferent party to the U.S. taxpayer that has not incurred the economic loss (identified as listed transactions on February 27, 2008)).

Notice 2015-73 – **Basket Option Contracts** - This notice describes certain transactions involving a contract that is denominated as an option referencing a basket of actively traded personal property. The Basket Option Contract attempts to defer income recognition and convert short-term capital gain and ordinary income to long-term capital gain using a contract denominated as an option contract. This notice was published in the Internal Revenue Bulletin on November 16, 2015. This notice was previously listed under Notice 2015-47 which was revoked.

Notice 2017-10 – **Syndicated Conservation Easement Transactions** - This notice describes certain transactions in which some promoters are syndicating conservation easement transactions that purport to give investors the opportunity to obtain charitable contribution deductions in amounts that significantly exceed the amount invested. The promoters identify a pass-through entity that owns real property, or form a pass-through entity to acquire real property. Additional tiers of pass-through entities may be formed. The promoters then syndicate ownership interests in the pass-through entity or tiered entities that owns the real property, suggesting to prospective investors that they may be entitled to a share of a charitable contribution deduction that equals or exceeds two and one-half times the amount of the investor's investment. The promoters obtain an inflated appraisal of the conservation easement based on unreasonable conclusions

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about the development potential of the real property. The entity then donates a conservation easement encumbering the property to a tax-exempt entity. Investors then claim a charitable contribution relying upon the pass-through entity's holding period.

"De-Listed" Transactions

- Notice 2004-65 - De-lists Producer Owned Reinsurance Companies (PORC) as a listed transaction
  - News Release dated 09-24-2004
- Notice 2004-64 Modification of exemption from tax for small property and casualty insurance companies.
- Notice 2002-70 modified by Notice 2004-65.

This information was last reviewed or updated by the IRS on 1/25/17.

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B. LOSS TRANSACTIONS

This information is taken from the IRS webpage that addresses disclosure of loss reportable transactions, which can be found at the following link:

https://www.irs.gov/businesses/disclosure-of-loss-reportable-transactions

Disclosure of Loss Reportable Transactions

Congress has enacted a series of income tax laws designed to halt the growth of abusive tax avoidance transactions. These provisions include the **disclosure of reportable transactions**. Each taxpayer that has participated in a reportable transaction and that is required to file a tax return must disclose information for each reportable transaction in which the taxpayer participates. Use Form 8886 to disclose information for each reportable transaction in which participation has occurred. Generally, Form 8886 must be attached to the tax return for each tax year in which participation in a reportable transaction has occurred. If a transaction is identified as a listed transaction or transaction of interest after the filing of a tax return (including amended returns), the transaction must be disclosed either within 90 days of the transaction being identified as a listed transaction or a transaction of interest or with the next filed return, depending on which version of the regulations is applicable. See the regulations under section 1.6011-4 for more information.

Material advisors with respect to any reportable transaction must also disclose information about the transaction on Form 8918. This requirement applies to material advisors who provide material aid, assistance, or advice on any reportable transaction after October 22, 2004.

One reportable transaction that must be disclosed is a loss transaction.

Losses that must be reported on Forms 8886 and 8918

If a taxpayer claims a loss under § 165 of at least one of the following amounts on a tax return, then the taxpayer has participated in a loss transaction and must file Form 8886. If an advisor provides material aid, assistance, or advice on a transaction that results in a taxpayer claiming a § 165 loss of at least one of the following amounts and meets other filing requirements; then the advisor is a material advisor and must file Form 8918.

- For individuals, at least $2 million in a single tax year or $4 million in any combination of tax years.
- For corporations (excluding S corporations), at least $10 million in any single tax year or $20 million in any combination of tax years.
- For partnerships with only corporations (excluding S corporations) as partners (looking through any partners that are also partnerships), at least $10 million in any single tax year or $20 million in any combination of tax years, whether or not any losses flow through to one or more partners.
- For all other partnerships and S corporations, at least $2 million in any single tax year or $4 million in any combination of tax years, whether or not any losses flow through to one or more partners or shareholders.
- For trusts, at least $2 million in any single tax year or $4 million in any combination of tax years, whether of not any losses flow through to one or more beneficiaries.
- A loss from a foreign currency transaction under Internal Revenue Code section 988 is a loss transaction if the gross amount of the loss is at least $50,000 in a single tax year for individuals or trusts, whether or not the loss flows through from an S corporation or partnership.

Taxpayers whose filed return does not reflect a section 165 loss that equals or exceeds the applicable threshold amount have not participated in a loss transaction. If you are a partner, shareholder, or beneficiary of a pass-

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through entity, you have participated in a loss transaction if your tax return reflects a section 165 loss allocable to it from the pass-through entity that equals or exceeds the applicable threshold amount.

Losses that do not have to be reported on Forms 8886 and 8918:

- Losses from casualties, thefts, and condemnations
- Losses from Ponzi Schemes
- Losses from the sale or exchange of an asset with a qualifying basis
- Losses arising from any mark-to-market treatment of an item
- Certain Swap losses (see Notice 2006-16)

For additional information on losses that do not have to be reported on Form 8886, see Revenue Procedure 2004-66 and Revenue Ruling 2009-9

This information was last reviewed or updated by the IRS on 3/7/17.

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C. TRANSACTIONS OF INTEREST (TOI)

This information is taken from the IRS webpage that addresses disclosure of loss reportable transactions, which can be found at the following link:

https://www.irs.gov/businesses/corporations/transactions-of-interest

The new reportable transaction category Transaction of Interest (TOI) is defined as a transaction that the IRS and the Treasury Department believe is a transaction that has the potential for tax avoidance or evasion, but lack sufficient information to determine whether the transaction should be identified specifically as a tax avoidance transaction. The TOI category of reportable transactions will apply to transactions entered into on or after November 2, 2006.

The following transactions have been identified and classified by the Internal Revenue Service as “Transactions of Interest”. Transactions that are the same as, or substantially similar to, these transactions are subject to the disclosure requirements of § 6011 (§ 1.6011-4), the material advisor disclosure statement requirements of § 6111 (§§ 301.6111-1, 301.6111-2, 301.6111-3), and the list maintenance requirements of § 6112 (§ 301.6112-1).

Persons required to file material advisor disclosure statements under § 6111 who have failed to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of investors under § 6112 who have failed to do so (or who fail to provide such lists when requested by the IRS) may be subject to the penalty under § 6708(a). In addition, the IRS may impose penalties on parties involved in these or substantially similar transactions, including the accuracy-related penalty under § 6662.

Notice 2007-72 - August 14, 2007 Contribution of Successor Member Interest - This transaction involves a taxpayer directly or indirectly acquiring certain rights in real property or in an entity that directly or indirectly holds real property, transfers the rights more than one year after the acquisition to an organization described in § 170(c) of the Internal Revenue Code, and claims a charitable contribution deduction under § 170 that is significantly higher than the amount that the taxpayer paid to acquire the rights.

Notice 2007-73 - This transaction uses a grantor trust, and the purported termination and subsequent re-creation of the trust’s grantor trust status, for the purpose of allowing the grantor to claim a tax loss greater than any actual economic loss sustained by the taxpayer or to avoid inappropriately the recognition of gain.

Notice 2008-99 - October 31, 2008 - Potential for Avoidance of Tax Through Sale of Charitable Remainder Trust Interests - This transaction involves a sale or other disposition of all interests in a charitable remainder trust (subsequent to the contribution of appreciated assets to and their reinvestment by the trust), results in the grantor or other noncharitable recipient receiving the value of that person's trust interest while claiming to recognize little or no taxable gain.

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Notice 2009-7 - On December 29, 2008 IRS and Treasury identified a new transaction of interest that uses a domestic partnership to prevent the inclusion of subpart F income. In this transaction a U.S. taxpayer that owns controlled foreign corporations (CFCs) that hold stock of a lower-tier CFC through a domestic partnership takes the position that subpart F income of the lower-tier CFC or an amount determined under section 956(a) of the Internal Revenue Code (Code) related to holdings of United States property by the lower-tier CFC does not result in income inclusions under section 951(a) for the U.S. taxpayer.

Notice 2015-74 - Basket Contracts. This notice describes certain transactions denominated as an option, notional principal contract, forward contract, or other derivative contract to receive a return based on the performance of a basket of referenced assets (the "reference basket"). The assets that comprise the reference basket may include (1) interests in entities that trade securities, commodities, foreign currency, or similar property ("hedge fund interests"), (2) securities, (3) commodities, (4) foreign currency, or (5) similar property (or positions in such property). The Basket Contracts attempt to defer income recognition and may attempt to convert short-term capital gain and ordinary income to long-term capital gain. This notice was published in the Internal Revenue Bulletin on November 16, 2015.

Notice 2016-66 – Section 831(b) Micro-Captive Insurance. This notice describes transactions in which a taxpayer attempts to reduce the aggregate taxable income of the taxpayer, related persons, or both, using contracts that the parties treat as insurance contracts and a related company that the parties treat as a captive insurance company. Each entity that the parties treat as an insured entity under the contracts claims deductions for premiums for insurance coverage. The related company that the parties treat as a captive insurance company elects under § 831(b) of the Internal Revenue Code (the "Code") to be taxed only on investment income and therefore excludes the payments directly or indirectly received under the contracts from its taxable income. The manner in which the contracts are interpreted, administered, and applied is inconsistent with arm's length transactions and sound business practices.

Notice 2017-8 – Section 831(b) Micro-Captive Transactions, amends the due date for filing of a disclosure with the Office of Tax Shelter Analysis for Notice 2016-66 transactions.

This information was last reviewed or updated by the IRS on 1/25/17.

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D. EDA-130

The EDA-130 fill-in form is available on the Intranet under “Audit” and then “Forms”. The pdf file can also be saved to your hard drive. For your reference, the form has been copied and pasted on the following two pages.

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Use your mouse or Tab key to move through the fields. Use your mouse or space bar to enable check boxes.

Illinois Department of Revenue

EDA-130 Information Document Request for Tax Avoidance Transactions

General Information

The purpose of this document is to identify if a taxpayer has directly or indirectly participated in any transaction that the Internal Revenue Service (IRS) may consider an abusive tax avoidance transaction. For more information, see Page 2, Abusive Tax Avoidance Transaction Information.

If you have not participated in any abusive tax avoidance transactions, please sign the declaration at the bottom of this form and return it to the auditor.

Identify the taxpayer and audit period (auditors)

Name: _____

Address: _____

_____

FEIN: _____

Audit Period: _____

Submitted to: _____

Date submitted: _____

Auditor's name: _____

Auditor's address: _____

_____

_____

Auditor's phone no.: _____

Step 1: Provide the following documents for the entire audit period (taxpayers)

Documents Requested

1. A description of all listed and reportable transactions, including all of the material facts
2. A description of the tax treatment of all listed or reportable transactions that resulted in a tax benefit
3. Information identifying the amounts involved and the General Ledger accounts affected by any part of any listed or reportable transactions. Please trace all identified items and amounts as line items on the tax returns.
4. Copies of all contracts and other documents pertaining to listed transactions
5. The names and addresses of all parties who promoted, solicited, or recommended participation in any listed or reportable transaction, and to whom fees or other compensation were paid in connection with the transaction.
6. The details of any tax strategies that were disclosed to any other state
7. Copies of requests made to the IRS to determine if any transaction you participated in should have been disclosed as a listed or reportable transaction. Include any responses you have received.
8. Details of any other state's tax shelter initiatives that you have responded to or entered into agreement with, including copies of any signed agreements
9. Any federal Forms 8886 and 8271 that you filed with the IRS, but have not previously provided to the Illinois Department of Revenue

Step 2: Sign the declaration, if applicable (taxpayers)

If you have not participated directly or indirectly in any listed or other reportable transaction, please sign here.

_____ _____

Taxpayer's signature Title

EDA-130 Front (R-04/12) Reset Print

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Abusive Tax Avoidance Transaction Information

As part of a joint effort with the Internal Revenue Service, Illinois is taking measures to identify and eliminate any potential tax avoidance transactions. One way of preventing the use of such transactions is to require the submission of documents that were missing during the original filing of a return.

Specific Instructions

Step 1: Provide the following documents for the entire audit period (taxpayers)

Definitions

The following information will help you to define certain terms in the document list.

"Reportable Transaction" **–**

A reportable transaction is one that warrants investigation because it possesses certain characteristics common in tax avoidance transactions. Listed transactions are included as one type of reportable transaction. Other reportable transactions include,

- confidential transactions
- transactions with contractual protection
- loss transactions
- transactions of interest

In general, a taxpayer has participated in a reportable transaction if the taxpayer's tax return reflects a tax benefit from the transaction. For more information, see Income Tax Act Section 1.6011-4(c)(3).

"Listed Transaction" **–**

The IRS defines listed transactions as transactions that are the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction. These transactions are identified by notice, regulation, or other form of published guidance as a listed transaction. For more information, see Income Tax Act Section 1.6011-4(b)(2).

"Substantially Similar" **–**

A transaction is substantially similar to another transaction if it is expected to obtain the same or similar type of tax consequences and is either factually similar or based on the same or similar tax strategy. For more information, see Income Act Section 1.6011-4(c)(4).

For more information regarding reportable or listed transactions,

- see Treasury Regulation 1.6011-4.
- visit the IRS website at **www.irs.gov**
- read IRS Publication 550

What if I do not submit the required documents?

You are required to provide the documents that are requested on this form if you participated in any reportable transaction. Failure to disclose participation in a listed or other reportable transaction may result in the assessment of non-disclosure penalties. For more information regarding the penalties, see the Illinois Income Tax Act, Sections 1001(b), 1005(b), 1005(c), and 1005(d).

If you did not participate in any potentially reportable transaction, you must sign the declaration on this form and return it to the auditor.

Step 2: Sign the declaration, if applicable (taxpayers)

If you did not participate in any reportable transactions, you must sign the declaration at in Step 2.

EDA-130 Back (R-04/12)

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PENALTY AND INTEREST
UPIA

Issued 10/2014
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I. PURPOSE

The purpose of this chapter is to provide the auditor with the information necessary to be able to properly calculate UPIA penalties and interest in various types of audit situations. For assistance on the application and calculation of Pre-UPIA penalty and interest, contact Technical Support.

II. REFERENCE SOURCES

A. Uniform Penalty and Interest Act (UPIA)

B. Illinois Income Tax Act (IITA)

Sec. 804 Failure to Pay Estimated Tax
Sec. 806 Exemption from Penalty
Sec. 1006 Frivolous Returns
Sec. 1007 Failure to register tax shelter or maintain list
Sec. 1008 Promoting tax shelters

C. Illinois Regulations (IAC)

86 IAC § 100.5230 Combined Estimated Tax Payments
86 IAC § 100.5250 Liability for Combined Tax, Penalty and Interest
86 IAC Part 700 Uniform Penalty and Interest Act

D. Department Publications

Pub-103 Penalties and Interest for Illinois Taxes
IL-2210 Computation of Penalties for Individuals
IL-2220 Computation of Penalties for Businesses

III. GENERAL INFORMATION

An in-depth discussion of the statutes involved in deemed assessed and proposed penalties can be found in Chapter 21 Due Dates/Extensions/Statutory Control.

Effective January 1, 1994 the Uniform Penalty and Interest Act (UPIA) contains all of the penalty and interest provisions for most of the taxes administered by the Illinois Department of Revenue. The old penalty and interest provisions were either deleted from the IITA or references to UPIA were added.

Section 1003 Interest on Deficiencies of the IITA provides that any amount of tax required to be paid under the IITA, which is not paid on or before the date prescribed for payment, shall have interest assessed on it. Interest is deemed assessed upon the assessment of the tax to which it relates. Interest is an amount which, in addition to tax and penalties, is due to the Department or refundable to the taxpayer.

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For returns due on and after January 1, 2001, interest is no longer computed on penalties, only tax. Ref: UPIA § 3-2(c) and (c-5)

The various sections of the UPIA have differing effective dates:

1. The interest on tax provisions of the UPIA went into effect January 1, 1994 for all outstanding liabilities and overpayments regardless of the liability period to which the liability or overpayment relates.

2. The penalty, interest on penalty and unprocessable return provisions went into effect for liability periods with original due dates on or after January 1, 1994. These liability periods are:

    a. Corporations (including Subchapter S corporations) with tax years ending on or after October 31, 1993.

    b. Individuals, partnerships, trust and estates with tax years ending on or after September 30, 1993.

    c. Certain exempt organizations with tax years ending on or after August 31, 1993.

    d. Cooperatives with tax years ending on or after April 31, 1993.

3. The date of overpayment provisions for claims which are filed to carry back an Illinois net loss go into effect for claims which are filed on or after January 1, 1994 regardless of the loss or carry year involved. UPIA § 3-9(c).

For a more complete legislative history of the IITA penalty and interest provisions refer to Chapter 48 Major Legislation Changes.

A. Amnesty Program

1. Tax Amnesty Act 2003

On June 20, 2003, the Tax Delinquency Amnesty Act was signed into law, providing the opportunity for Illinois taxpayers to pay outstanding tax liabilities, file delinquent returns, and have 100% of the related interest and penalties abated.

Tax periods eligible for amnesty treatment under the 2003 act included those ending June 30, 1983 and prior to July 1, 2002. The Department abated 100% of the interest and penalties related to the tax that was paid under amnesty, and the Department did not seek civil or criminal prosecution for any taxpayer for the period of time for which amnesty was granted. However, penalty and interest imposed under the UPIA are doubled for eligible tax periods, if a tax liability eligible for amnesty was not paid during amnesty. Penalties imposed by other acts and interest for periods before the UPIA

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became effective are not affected. The amnesty payment period ran from October 1, 2003 through November 15, 2003.

2. Tax Amnesty Act 2010

The Tax Delinquency Amnesty Act was amended on August 16, 2010 to implement a new Amnesty program in 2010.

Tax periods eligible for Amnesty treatment under the 2010 act included those ending after June 30, 2002, and prior to July 1, 2009. The Amnesty Program Period ran from October 1, 2010, through November 8, 2010. In order to qualify for Amnesty, taxpayers must have had an outstanding Eligible Liability for a tax period covered under the Amnesty Program. An "Established Liability", which is an Eligible Liability that was assessed or became final prior to October 1, 2010, had to be paid in full during the Amnesty Program Period in order to qualify for penalty and interest abatement. For an "Eligible Liability" that had not been assessed, the taxpayer was required to file and pay the appropriate original or amended return for that liability, during the Amnesty Program Period, in order to participate in Amnesty. Penalty and interest were waived if the total tax liability was paid during the Amnesty Program Period. However, if the taxpayer failed to pay the full amount of an Established Liability during the Amnesty Program Period, a 200% Sanction was imposed on the full liability.

Amnesty needs to be taken into consideration when auditing years that fall within the Amnesty Period, as tax liabilities not paid during the Amnesty Period result in the doubling of UPIA penalties and interest*, including liabilities resulting from RARs and other federal changes not finalized as of the end of the 2003 Amnesty Program Period*. The Department's position for charging double interest on unfinalized federal changes as of the end of the 2003 Amnesty Program Period resulting from RARs is supported by court case Metropolitan Life Insurance Co vs Brian Hamer, 990 N.E.2d 1144 (2013). Liabilities resulting from RARs not finalized as of the end of the 2010 Amnesty Program Period, are only subject to single penalty (if applicable) and interest rates. REF: IAC 520.101(b)(1)(A).

3. Tax Amnesty Act 2019

The Tax Delinquency Amnesty Act was amended on June 5, 2019 to implement a new Amnesty program for 2019.

Tax periods eligible for Amnesty treatment under the 2019 act included those ending after June 30, 2011 and prior to July 1, 2018. The Amnesty Program Period ran from October 1, 2019 through November 15, 2019. In order to qualify for Amnesty, taxpayers must have had an outstanding Eligible Liability for a tax period covered under the Amnesty Program. An "Established Liability", which is an Eligible Liability that was assessed or became final prior to October 1, 2019, had to be paid in full during the Amnesty Program Period in order to quality for penalty and interest abatement. For an "Eligible Liability" that had not been assessed, the taxpayer was required to file and pay

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the appropriate original or amended return for that liability, during the Amnesty Program period, in order to participate in Amnesty. Penalty and interest were waived if the total tax liability was paid during the Amnesty Program Period.

The regulations, rules and audit procedures are similar to the 2010 amnesty program except there is no doubling of penalty and interest if the tax liability is not paid during the 2019 amnesty payment period.

Further information regarding Illinois' Tax Amnesty Program can be found in Audit Manual Chapter 2 Amnesty.

B. Interest Rates

Interest rates are currently governed by the Uniform Penalty and Interest Act § 3-2(a) and (b). Prior to UPIA the rates were governed by PA 79-838 and the U.S. Tax Reform Act of 1986.

1. Periods After 12/31/2013 and Prior to 1/1/2004

For all outstanding liabilities and overpayments the interest rate to be paid to taxpayers and to be charged taxpayers is the underpayment rate established under IRC § 6621. The interest rate will be adjusted semiannually on January 1 and July 1 based on the underpayment rate going into effect on that January 1 or July 1 under IRC § 6621. The change in rate after the first year has been eliminated.

FEDERAL UNDERPAYMENT RATE

1/1/2014	-	06/30/2014	3%
7/1/2014	-	12/31/2014	3%
1/1/2015	-	06/30/2015	3%
7/1/2015	-	12/31/2015	3%
1/1/2016	-	06/30/2016	3%
7/1/2016	-	12/31/2016	4%
1/1/2017	-	06/30/2017	4%
7/1/2017	-	12/31/2017	4%
1/1/2018	-	06/30/2018	4%
7/1/2018	-	12/31/2018	5%
1/1/2019	-	06/30/2019	6%
7/1/2019	-	12/31/2019	5%

The annual interest rates, which were in effect from 1969 to December 31, 2003, are as follows:

8/1/1969	-	9/7/1975	6%
9/8/1975	-	1/31/1976	9%
2/1/1976	-	1/31/1978	7%
2/1/1978	-	1/31/1980	6%

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2/1/1980	-	1/31/1982	12%
2/1/1982	-	12/31/1982	20%
1/1/1983	-	6/30/1983	16%
7/1/1983	-	12/31/1984	11%
1/1/1985	-	6/30/1985	13%
7/1/1985	-	12/31/1985	11%
1/1/1986	-	6/30/1986	10%
7/1/1986	-	12/31/1993	9%
1/1/1994	-	6/30/1994	7%
7/1/1994	-	12/31/1994	8%
1/1/1995	-	6/30/1995	9%
7/1/1995	-	12/31/1995	9%
1/1/1996	-	6/30/1996	9%
7/1/1996	-	12/31/1996	9%
1/1/1997	-	6/30/1997	9%
7/1/1997	-	12/31/1997	9%
1/1/1998	-	6/30/1998	9%
7/1/1998	-	12/31/1998	8%
1/1/1999	-	6/30/1999	7%
7/1/1999	-	12/31/1999	8%
1/1/2000	-	6/30/2000	8%
7/1/2000	-	6/30/2001	9%
7/1/2001	-	12/31/2001	7%
1/1/2002	-	6/30/2002	6%
7/1/2002	-	12/31/2002	6%
1/1/2003	-	6/30/2003	5%
7/1/2003	-	12/31/2003	5%

2. Periods After 12/31/2003 and Prior to 1/1/2014

For all outstanding liabilities and overpayments the rate of interest payable to taxpayers and to be charged taxpayers is the "short-term federal rate" **for the first year that the overpayment or underpayment accrues interest"**. Thereafter, interest is charged or paid at a rate equal to the federal underpayment rate. The following table reflects rates for interest accruing from 1/1/2004 to 12/31/2013:

SHORT-TERM INTEREST RATE				FEDERAL UNDERPAYMENT RATE			
1/1/2004	-	12/31/2004	1%	1/1/2004	-	12/31/2004	4%
1/1/2005	-	06/30/2005	2%	1/1/2005	-	06/30/2005	5%
7/1/2005	-	12/31/2005	3%	7/1/2005	-	12/31/2005	6%
1/1/2006	-	06/30/2006	4%	1/1/2006	-	06/30/2006	7%
7/1/2006	-	12/31/2007	5%	7/1/2006	-	12/31/2007	8%
1/1/2008	-	06/30/2008	4%	1/1/2008	-	06/30/2008	7%
7/1/2008	-	06/30/2009	2%	7/1/2008	-	06/30/2009	5%
7/1/2009	-	12/31/2010	1%	7/1/2009	-	12/31/2010	4%

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1/1/2011	-	06/30/2011	0%	1/1/2011	-	06/30/2011	3%
7/1/2011	-	12/31/2011	1%	7/1/2011	-	12/31/2011	4%
1/1/2012	-	06/30/2012	0%	1/1/2012	-	06/30/2012	3%
7/1/2012	-	12/31/2012	0%	7/1/2012	-	12/31/2012	3%
1/1/2013	-	06/30/2013	0%	1/1/2013	-	06/30/2013	3%
7/1/2013	-	12/31/2013	0%	7/1/2013	-	12/31/2013	3%

Current and past interest rates can also be accessed at:

https://www2.illinois.gov/rev/individuals/Pages/interestrate.aspx

C. Reasonable Cause

UPIA § 3-8 [35 ILCS 735/3-8] provides that the Illinois Department of Revenue can abate penalties imposed under the provisions of UPIA § 3-3, 3-4, 3-5 and 3-7.5 if the taxpayer can demonstrate reasonable cause for noncompliance. The late-payment penalty for underpayment of estimated tax of the IITA is also included per IITA § 804(e). **UPIA does not authorize the Department to abate interest.**

Refer to Audit Manual Chapter 3, Reasonable Cause, IAC §700.400 and Reasonable Cause Guide on Sp•IDOR Web for guidelines and procedures on reasonable cause for abatement of UPIA and Pre-UPIA penalties.

D. Penalty and Interest Relief

There are occasions when the Department will find it necessary to provide assistance to taxpayers who have encountered hardships, either due to natural disasters or other unanticipated events that affect taxpayer filing capabilities, by providing relief from penalties and interest.

Illinois income tax parallels federal income tax by conforming to IRS guidelines with respect to any tax relief granted relating to national natural disasters. Under IITA § 601(a), if the IRS extends a due date for payment of tax, no penalty or interest is imposed if payment of the equivalent Illinois tax is made by that date. Also, if the IRS extends a due date for filing a federal return or making a payment because of a natural disaster or a holiday, IAC § 100.5020(e)(4) provides that any taxpayer who files the equivalent Illinois return by that extended due date automatically has reasonable cause for late filing and IAC § 100.6000 provides that payment of the equivalent Illinois tax by the extended due date is timely.

For a list of current and past events, refer to the Exhibit A – Penalty and Interest Relief.

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IV. APE SPECIFIC LAW APPLICATIONS

A. Penalties

Refer to Publication 103, Penalties and Interest for Illinois Taxes, for additional explanation of penalties and interest assessed on returns due on or after January 1, 1994.

1. Penalty for Failure to File

It is important to note that the extended due date of a return is used to determine if a late filing penalty applies. However, it is the unextended due date of the return that determines which UPIA provision applies for purposes of imposing any penalty or interest on tax.

The late-filing penalty is only assessed in the following audit situations:

- Non-filer
- Original return filed late
  - Amended return amount
  - Audit liability amount

a) Returns Due On and After January 1, 2001 (UPIA § 3-3(a-10))

(1) Penalty Rate

Tier One:

2%, up to a maximum of $250, if return is not filed by the extended due date

Tier Two:

2% or $250, whichever is greater, not to exceed $5,000, if return is not filed within 30 days of notice of non-filing, in addition to any applicable Tier One penalty.

(2) Penalty Basis

Tier One:

Tax required to be shown due on a return reduced by any timely payments and properly allowable credits.

Tier Two:

Tax required to be shown due on a return before applying any timely payments and properly allowable credits.

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b) Returns Due On and After January 1, 1996 and On or Before December 31, 2000 (UPIA § 3-3(a-5))

(1) Penalty Rate

Tier One:

2%, up to a maximum amount of $250, if not filed by the extended due date.

Tier Two:

2% or $250, whichever is greater, not to exceed $5,000, if return is not filed within 30 days of notice of non-filing, in addition to any applicable Tier One penalty.

(2) Penalty Basis

Tier One and Tier Two

Tax required to be shown due on a return before applying any timely payments and properly allowable credits.

c) Returns Due Before January 1, 1996 (UPIA § 3-3(a))

(1) Penalty Rate

5%, if not filed by the extended due date

(2) Penalty Basis

Tax required to be shown on the return. This is the total amount of income and replacement tax reported on the original return, taking into consideration the Article 2 credits (i.e. Enterprise Zone Investment Credits, Replacement Tax Investment Credits, etc.) but WITHOUT TAKING INTO CONSIDERATION ANY PAYMENTS FOR THE TAX YEAR OR CREDIT CARRYFORWARDS FROM A PREVIOUS YEAR.

Example: Corporation A, a calendar year taxpayer, made timely estimated payments of $900,000 during 1993. On March 15, 1994, Corporation A made an IL-505 payment of $200,000. On December 1, 1994, Corporation A filed its IL-1120 for 1993 reporting a tax liability of $1,000,000 and requesting a refund of $100,000.

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Since Corporation A did not file its return timely, a UPIA §3-3(a) penalty would apply. The penalty would be 5% of the tax required to be shown on the return ($1,000,000) or $50,000. Therefore, Corporation A's requested overpayment of $100,000 would be reduced by the UPIA § 3-3(a) penalty of $50,000 (plus interest on the penalty).

If a UPIA § 3-3(a) penalty is applied to any tax year, the penalty will accrue interest from the original due date of the return (without extensions) until the date the penalty is paid or until the date the notice and demand is issued, provided the total amount shown due on the notice and demand is paid within 30 days of issuance of the notice and demand.

For more information regarding the accrual of interest on UPIA penalties, refer to Interest on Penalties.

If a penalty for late filing or nonfiling is imposed in addition to a penalty for late payment, the total penalty due shall be the sum of the late-filing penalty and the applicable late-payment penalty.

The enactment of the Uniform Penalty and Interest Act does not affect the assessment procedures or the abatement causes (with the exception of the reasonable cause guidelines) or procedures for the late-filing or nonfiling penalty. It also does not affect the determination of whether a company is a nonfiler or not in the case of a combined return.

IT IS IMPORTANT TO NOTE that if an ORIGINAL RETURN is filed late, and reasonable cause does not apply, the UPIA § 3-3(a), (a-5) and (a-10) penalty basis is increased by any subsequent increases to the tax required to be shown on the return. This would include math errors, amended returns, federal audit adjustments (even if filed within 120 days) or Illinois audit adjustments. If a subsequent action reduces the tax required to be shown on the return, the UPIA § 3-3(a), (a-5) and (a-10) penalty basis is reduced accordingly. REF: UPIA § 3-3(d). This is true even if the tax required to be shown on the return is subsequently being reduced due to an Illinois net loss, federal net operating or capital loss or an Illinois Article 2 credit being carried forward on an amended return or as a result of an audit. HOWEVER, THE CARRYBACK OF AN ILLINOIS NET LOSS OR A FEDERAL CAPITAL LOSS WILL NOT REDUCE THE UPIA § 3-3(a), (a-5) or (a-10) PENALTY BASE.

d) Assessment of the Penalty

Effective for tax years ending on or after December 31, 1973, IITA § 1002(e)(2) was amended to state that the late-filing penalty is considered deemed assessed when the return is filed. Therefore, any amount of the penalty, that is attributable to a liability that is reported on an original or amended return, is considered deemed assessed. Any penalty imposed when a taxpayer never files an original return or that is attributable to an unreported federal change or audit liability for which a Notice of Deficiency is issued may only be assessed after a notice of deficiency is

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issued for the penalty. It is important to determine the proper method of assessment of any late-filing penalty in order to protect the statute of limitations for its collection.

For more information on what liabilities are deemed assessed and what liabilities are protestable in the case of an amended return being filed and the Department having no record of an original on file, refer to Chapter 21 Due Dates/Extensions/Statutory Control.

For further information regarding the statutes involved in deemed assessed and protestable liabilities, refer to Chapter 21 Due Dates/Extensions/Statutory Control.

For tax years in which the Income Tax liability and the Replacement Tax liability of a corporation were computed on separate returns, the Department took the position that the timely filing of either return was considered to be a timely filing of both returns. This position was based on the fact that Illinois had only one Act, which encompassed both taxes and only one provision for the Statute of Limitations for assessing any resulting tax, penalty and interest.

e) Combined Returns

When dealing with corporations that are members of a unitary group that has elected to file an Illinois combined return or is required to do so, two situations involving "nonfilers" can occur.

If an eligible member fails to include its income and factors (everywhere and Illinois) in the combined return, the tax liability of that member is determined on the basis of IAC § 100.5210(b) as follows:

- If the designated agent of the combined group claims or agrees with the auditor that the company was omitted from the group due to a mistake of law or fact or inadvertently, the member is treated as if it had been a member of the combined group from the beginning and, if the combined return was timely filed, NO LATE-FILING PENALTY IS APPLICABLE.

- If the designated agent does not agree with the auditor's findings, the omitted member is treated as a member of the unitary group filing a separate unitary return for Illinois purposes.

    - For tax years ending prior to December 31, 1993, when joining in a combined return was elective, the company is a nonfiler unless it filed its own return or joined in a combined return with another group, the LATE-FILING PENALTY SHOULD BE APPLIED.

    - For tax years ending on or after December 31, 1993, and prior to December 31, 2013, the combined return is the only required return, and the company is not subject to the late filing penalty for failing to join in the filing.

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- For tax years ending on or after December 31, 2013, the company is a nonfiler subject to the late filing penalty unless it filed its own return or joined in a combined return with another group. Ref. IITA § 905(c).

If a combined return is filed and one of the companies which is included in the return as an Illinois non-filing member is determined, per audit, to have sufficient activities in Illinois to cause it to be taxable in this state, the member's Illinois factors should be included in the apportionment formula of the revised combined return. However, THE COMPANY IS NOT CONSIDERED AN ILLINOIS NONFILER AND NO LATE-FILING PENALTY SHOULD BE APPLIED.

f) Unprocessable Returns

UPIA § 3-2(d) contains the requirements an original return must meet in order for it to be considered processable. These requirements do not pertain to amended returns. An original return is processable if it:

1. Is in the form prescribed or approved by the Department,
2. Is signed by the person authorized by law, and
3. Contains all information, schedules, and supporting documents necessary to determine the tax due and to make allocations of tax as prescribed by law.

If any original return does not meet any one of these three requirements, it is considered unprocessable. The Department must notify the taxpayer that the original return has been deemed to be unprocessable and identify the areas of the return, which need to be corrected.

Examples of errors that cause a return to be considered unprocessable are:

1. No signatures
2. Use of a form not approved by the Department
3. Incomplete forms necessary for allocation of tax
4. Using the wrong forms for the tax being reported
5. Remittances received without returns

Examples of errors that do not cause a return to be unprocessable are:

1. Mathematical errors
2. Transposition errors
3. Attempts to claim an unacceptable subtraction
4. Bringing the wrong figures forward from a schedule
5. Subtractions or credits claimed not allowable for liability period of return
6. Subtractions, credits or deductions not properly reported
7. Wrong tax rates used
8. Payment differences

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9. Exemption errors
10. Entries made on wrong lines
11. Incorrect accounts or liability periods used
12. Incorrect identification numbers used

If, in audit, the information is obtained which is necessary to perfect a return, the return will be considered FILED as of the date the auditor receives the information.

Example: Corporation A files its return for calendar year 2009 on October 15, 2010 without a signature. Corporation A fails to respond to any of the unprocessable notices issued by the Department. In 2012 an Illinois auditor begins an audit on the 2009 calendar year. On March 20, 2012, the taxpayer provides the auditor with a signed Jurat statement for the original, unsigned, unprocessable return. The taxpayer is considered to have filed the return for 2009 on March 20, 2012. The auditor will then complete the audit beginning with the as-filed numbers from the original return.

If an unprocessable return is filed on or before the date prescribed for filing (including extensions) AND THE RETURN IS PERFECTED WITHIN 30 DAYS (21 days for returns due before January 1, 1996) OF THE DATE THE UNPROCESSABLE NOTICE IS ISSUED, the perfected return will be considered to have been filed as of the date the original, unprocessable return was filed. Therefore, no UPIA § 3-3(a), (a-5) or (a-10) penalty will apply to the return.

If an unprocessable return is filed on or before the date prescribed for filing (including extensions) and the return is NOT perfected within 30 days (21 days for returns due before January 1, 1996) of the date the unprocessable notice is issued, the perfected return will be considered to have been filed as of THE DATE THE RETURN IS PERFECTED. In this case, a UPIA § 3-3(a) penalty or a Tier Two UPIA § 3-3(a-5) or (a-10) penalty will apply to the return based on the tax required to be shown due on the return with no reduction to the penalty base for timely tax payments or credit carryforwards.

If an unprocessable return is filed after the date prescribed for filing (including extensions) regardless of whether the return is perfected within 30 days (21 days for returns due before January 1, 1996) of the date the unprocessable notice is issued or not, the perfected return is considered to be filed late. Therefore, a UPIA § 3-3(a) penalty or a Tier One UPIA § 3-3(a-5) or (a-10) penalty would apply to the return, since the original, unprocessable return was filed late. If the return is not perfected within 30 days of the unprocessable notice, a Tier Two UPIA § 3-3(a-5) or (a-10) penalty will apply.

No refunds or credit carryforwards will be issued from the unprocessable return. If the return is not perfected within 3 years from the due date of the return (with extensions), any payments in excess of the tax liability for the year will be forfeited.

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There is no Statute of Limitations on the issuance of a Notice of Deficiency for the taxable year since an unprocessable return is a nonfiled return.

When the return is perfected does have an effect on the statute of limitations for issuing a Notice of Deficiency and on interest on overpayments.

For more information regarding the statute of limitations when an unprocessable return is involved, refer to Chapter 21 Due Dates/Extensions/Statutory Control.

2. ES Late Payment Penalty – Underpayment of Estimated Tax (f/k/a Section 804 Penalty)

THIS SECTION APPLIES TO LIABILITY PERIODS WITH ORIGINAL DUE DATES (WITHOUT REGARD TO EXTENSIONS) WHICH OCCUR ON OR AFTER JANUARY 1, 1994. REFER TO THE GENERAL INFORMATION SECTION OF THIS CHAPTER FOR A LISTING OF THE FISCAL YEARS AFFECTED BY UPIA.

With the enactment of UPIA, the ES Late Payment penalty was incorporated into the (b)(1) penalties of UPIA § 3-3.

The ES Late Payment Penalty in IITA applies solely to any underpayment of estimated tax and only affects the rate of the ES Late Payment penalty that is applied to any underpayment of estimated tax. It does not affect the computation of the amount of the underpayment, the assessment of the penalty or (with the exception of the reasonable cause abatement) the causes for abatement of or exceptions to the penalty.

Refer to chart in Chapter 21 Due Dates/Extensions/Statutory Control for Due dates for Estimated Payments & Returns for Individuals and Corporations.

a) ES Late Payment Penalty Exceptions

(1) Persons not required to make payments

(a) Individuals

i. Estimated tax expected is $500 or less (tax years ending on or after 12/31/2001)
ii. Estimated tax expected is $250 or less (tax years ending before 12/31/2001)
iii. Short tax years beginning before January 1, 2011 (IAC § 100.8010(j))
iv. Short taxable year of less than 4 months (IAC § 100.8010(f)(4)(A))

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(b) Residents of Nursing Homes

IITA § 806 contains an exemption to the ES Late Payment penalty for any taxpayer 65 years or older and is a permanent resident of a nursing home.

(c) Farmers

Individuals who are farmers having gross income from farming which is at least 2/3 of their total estimated gross income for the taxable year, are also exempt from paying estimated taxes per IITA § 803.

(d) Corporations

i. Estimated tax expected is $400 or less
ii. Short tax years beginning before January 1, 2011 (IAC § 100.8010(j))
iii. Short taxable year of less than 4 months (IAC § 100.8010(f)(4)(B))

(e) Estates, Trusts, Partnerships and Sub S Corporations

IITA § 803 exempts estates and trusts (IL-1041), partnerships (IL-1065) and subchapter S corporations (IL-1120-ST) from paying estimated taxes.

(2) No Return Required for Preceding Taxable Year

No penalty shall be imposed under IITA § 804 with respect to any installment of estimated tax required to be paid in a taxable year by a taxpayer who was not required to file an Illinois Income tax return under IITA § 502 for the preceding taxable year. (For tax years ending on or after December 31, 1998, IITA § 804(d)).

For individuals, no penalty will be imposed if the taxpayer had no tax liability for the preceding taxable year and such year was a taxable year of 12 months.

(3) Change in Apportionment Factor

No penalty shall be imposed under IITA § 804 on any underpayment of an installment of estimated tax due before July 9, 1998 (the effective date of PA 90-613, which enacted single sales factor in IITA § 304(h)) to the extent that underpayment is attributable solely to the taxpayer's change in apportionment from IITA § 304(a) to IITA § 304(h).

IAC § 100.8010(g) and (h) provide an expanded list of exceptions to the penalty imposed under IITA § 804 along with examples.

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b) Amount of Underpayment Defined

Because estimated tax payments are applied to the earliest installment first, until it is paid in full, before any is applied to a subsequent installment, the underpayment on which the penalty is based is the excess of the total of all estimated tax installments due for the taxable year on or before the installment date in question over the total payments made on or before that installment date. A credit carryforward from a prior year is considered a payment made on the first installment due date, regardless of when the return for that prior year was filed (for tax years 12/31/2013 and prior. For tax years 2014 and after credit carryforwards are applied to the tax period for which estimated payments currently are due as of the date the return is filed, unless an election to apply the credit to a different tax year is made. If the return is filed on or before the extended due date, the credit is considered paid on the due date of the first estimated tax installment of the tax period. However, if all or a portion of the overpayment results from payments made after the due date of the first estimated tax installment, that portion of the credit is considered to be paid on the date the payment was actually made. If the return is filed after the extended due date, that credit is considered paid on the file date of the return that made the election). There is no longer a need to determine the period of the underpayment. The ES Late Payment penalty rate is a flat rate rather than a per annum rate. If an estimated payment is 1 week late, 1 month late or never paid, the penalty rate for that estimated payment is the applicable rate for that period.

(1) For Tax Years Ending On or After December 31, 1990

IITA § 804 defines the amount of a required installment to be 25% of the required annual payment. The term “required annual payment” is then defined in IITA § 804(c)(1)(B) as the lesser of:

a. 90% of the tax shown on the return for the taxable year or, if no return is filed, 90% of the tax for such year, or

b. For installments due prior to 1/1/2011 and after 1/31/2012, 100% of the tax shown on the return of the taxpayer for the preceding taxable year, if a return showing a liability for tax was filed by the taxpayer for the preceding taxable year and such preceding year was a taxable year of 12 months, or

c. For installments due after 1/31/2011 and prior to 2/1/2012, 150% of the tax shown on the return of the taxpayer for the preceding taxable year, if a return showing a liability for tax was filed by the taxpayer for the preceding taxable year and such preceding year was a taxable year of 12 months.

Per IITA § 804(c)(2)(A), if a taxpayer’s “annualized income installment” is less than the required installment under the formula described above, the required installment is the annualized installment and the reduction is recaptured by increasing the amount of the next required installment by the amount of the

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reduction, and by increasing subsequent required installments to the extent that the reduction has not previously been recaptured.

IITA § 804(c)(2)(B)(i) and (ii) defines the "annualized income installment" as the excess, if any, of:

a. The applicable percentage of the tax for the taxable year computed by placing, on an annualized basis, the net income for the months in the taxable year ending before the due date for the installment, over

b. The aggregate amount of any prior required installments for the taxable year.

The applicable quarterly installment percentage required under the law is:

1st installment	22.5%
2nd installment	45%
3rd installment	67.5%
4th installment	90%

For the computation for annualized net income (which is used to determine the annualized income installment), contact Technical Support for assistance.

(2) For Tax Years Ending Prior to December 31, 1990

IITA § 804(b) defined the amount of the underpayment as the excess of:

a. The amount of the installment which would be required to be paid if the estimated tax were equal to 80% of the tax shown on the return for the taxable year or if no return was filed, 80% of the tax for such year, over

b. The amount, if any, of the installment paid on or before the last date prescribed for payment.

In other words, if the amount of the payment which was required to be paid, is more than the amount which was actually paid, the difference is the amount of the underpayment for that quarter.

c) Returns Due On and After January 1, 2005 (UPIA § 3-3(b-20)(1))

(1) Penalty Rate

Once it is determined that an underpayment of estimated tax exists and no abatement of or exception to the ES Late Payment penalty applies, a penalty should be computed equal to:

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- 2%, if paid no later than 30 days after the due date and
- 10%, if paid later than 30 days after the due date

(2) Penalty Basis

Any amount of underpayment of estimated tax.

If an ES Late Payment penalty is applied to any quarter of the tax year, the penalty will accrue interest from the original due date of the return (without extensions) for the year until the date the penalty is paid or until the date the notice and demand is issued, if the total amount shown due on the notice and demand is paid within 30 days of issuance of the notice and demand.

Refer to Chapter 43 GenTax Penalty and Interest Calculator, ES Late Payment Penalty Examples on how to calculate the 3-3(b-20)(1) penalty in GenTax.

For more information regarding the accrual of interest on UPIA penalties, refer to Interest on Penalties.

d) Returns Due On and After January 1, 2004 and On or Before December 31, 2004 (UPIA § 3-3(b-15))

(1) Penalty Rate

Once it is determined that an underpayment of estimated tax exists and no abatement of or exception to the ES Late Payment penalty applies, a penalty should be computed equal to:

- 2%, if paid not later than 30 days after the due date,
- 10%, if paid later than 30 days after the due date and not later than 90 days after the due date,
- 15%, if paid later than 90 days after the due date and not later than 180 days after the due date, and
- 20%, if paid later than 180 days after the due date

(2) Penalty Basis

Any amount of underpayment of estimated tax.

Refer to Chapter 43 GenTax Penalty and Interest Calculator, ES Late Payment Penalty Examples on how to calculate the 3-3(b-15) penalty in GenTax.

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e) Returns Due On and After January 1, 2001and On or Before December 31, 2003 (UPIA § 3-3(b-10)(1))

(1) Penalty Rate

Once it is determined that an underpayment of estimated tax exists and no abatement of or exception to the ES Late Payment penalty applies, a penalty should be computed equal to:

- 2%, if paid no later than 30 days after the due date,
- 5%, if paid later than 30 days after the due date and not later than 90 days after the due date,
- 10%, if paid later than 90 days after the due date and not later the 180 days after the due date, and
- 15%, if paid later than 180 days after the due date

(2) Penalty Basis

Any amount of underpayment of estimated tax.

Refer to Chapter 43 GenTax Penalty and Interest Calculator, ES Late Payment Penalty Examples on how to calculate the 3-3(b-10)(1) penalty in GenTax.

f) Returns Due On and After January 1, 1998 and On or Before December 31, 2000 (UPIA § 3-3(b-5)(1))

(1) Penalty Rate

Once it is determined that an underpayment of estimated tax exists and no abatement of or exception to the Late ES Payment penalty applies, a penalty should be computed equal to:

- 20%

(2) Penalty Basis

Any amount of underpayment of estimated tax

Refer to Chapter 43 GenTax Penalty and Interest Calculator, ES Late Payment Penalty Examples on how to calculate the 3-3(b-5)(1) penalty in GenTax.

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g) Returns Due On or After January 1, 1994 and On or Before January 1, 1998 (UPIA § 3-3(b)(1)

(1) Penalty Rate

Once it is determined that an underpayment of estimated tax exists and no abatement of or exception to the ES Late Payment penalty applies, a penalty should be computed equal to:

- 15%

(2) Penalty Basis

Any amount of underpayment of estimated tax.

Refer to Chapter 43 GenTax Penalty and Interest Calculator, ES Late Payment Penalty Examples on how to calculate the 3-3(b)(1) penalty in GenTax.

h) Assessment of the Penalty

(1) For Tax Years Ending On or After December 31, 1973

The ES Late Payment Penalty is deemed assessed upon the filing of the return for the taxable year, except if no return was filed for that year. REF: IITA § 1002(e)(2)

If no return is filed for the taxable year, the ES Late Payment Penalty is assessed in the same manner as any other deficiency. REF: IITA § 1002(e)(1)

If, during the course of an audit, it is determined that a ES Late Payment Penalty is due for a year ending after December 30, 1973, a separate audit report must be sent to Technical Review. The report should include Forms PROD-1, EDA-25, EDA-27, IL-804 and IL-2220 (where necessary) and a narrative describing why the penalty was imposed. This is extremely important because an income tax notice and demand must be issued prior to the time for filing a lien(s) (IITA § 902(a)). It is important to note that a wavier (IL-872) will not extend the time for issuing an income tax notice and demand to the taxpayer for an ES Late Payment Penalty because this is a deemed assessed penalty. The ES Late Payment Penalty is treated as a math error and once an income tax notice and demand has been sent to the taxpayer, collection of the ES Late Payment Penalty remains “open” for collection through lien procedures or by the offsetting of future overpayments.

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For more information regarding the statute of limitations on deemed assessed and protestable liabilities, refer to Chapter 21 Due Dates/Extensions/Statutory Control.

(2) For Tax Years Ending Before December 31, 1973

The ES Late Payment Penalty was treated as a protestable deficiency and was, therefore, placed on an IL-870.

i) Combined Returns – Application of ES Late Payment Penalty

EFFECTIVE FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1993, ALL ELIGIBLE MEMBERS OF A UNITARY BUSINESS GROUP MUST FILE A COMBINED RETURN TO REPORT THEIR ILLINOIS TAX LIABILITY.

IAC § 100.5230(c) and § 100.5250(c) govern the application of the ES Late Payment penalty to combined returns.

For purposes of determining whether a penalty for failure to timely pay tax should be imposed by UPIA § 3-3(b), § 3-3(b-5), § 3-3(b-10), § 3-3(b-15) and § 3-3(b-20) the following guidelines apply (REF: IAC § 100.5250(c)(2)):

- In the case where a corporation erroneously fails to join in the filing of a combined return for a common taxable year, neither that corporation nor the combined group shall be subject to any failure-to-pay penalty under UPIA § 3-3(b)(1), § 3-3(b-5)(1), § 3-3(b-10)(1), § 3-3(b-15) or § 3-3(b-20)(1) if timely payment is made of the tax shown on a separate return filed by such corporation or on a combined return in which it erroneously joins in filing for each taxable year ending with or within such common taxable year.

- A corporation which erroneously fails to join in the filing of a combined return for a common taxable year and also fails to timely pay the tax shown on a separate return it files or on a combined return in which it joins in filing for each taxable year ending with or within such common taxable year shall be subject to penalty under UPIA § 3-3(b)(1), § 3-3(b-5)(1), § 3-3(b-10)(1), § 3-3(b-15) or § 3-3(b-20)(1) only for failure to pay the tax shown on the return it actually files or joins in filing.

When dealing with combined returns, the following procedures should be followed for purposes of applying an ES Late Payment penalty:

- The amount of any penalty for underpayment of estimated tax is computed as if the electing members were one taxpayer.

- In the first combined return year (and for years ending prior to December 31, 1990), Exceptions #1 and #2 (under former IITA § 804(d)(1) and (2)) are

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determined based on the aggregate of the tax and income shown on the returns filed for the previous year. Contact Technical Support for assistance.

- If former electing members properly file separate returns for the taxable year following a combined return year, and combined estimated payments were made for that following year, the payments are allocated to the members in a manner determined by the designated agent as long as the manner is satisfactory to the Department.

The designated agent's method will be satisfactory to the Department as long as it does not jeopardize the collection of any liability. REF: IAC § 100.5230(a).

For years ending prior to December 31, 1990, Exceptions #1 and #2 will be determined based on each former electing member's allocated share of tax and income from the combined return filed for the previous year. The allocated shares shall be reported to the Department by the designated agent in the manner prescribed in the instructions to Schedule UB.

- If combined estimated payments are made but separate returns are filed for a tax year NOT following a combined return year and no combined return is filed for the current year, the estimated tax shall be credited ONLY TO THE CORPORATION THAT MADE THE PAYMENT.

Several examples of these rules for applying the ES Late Payment penalty to members of a combined return are included in IAC § 100.5230(e).

j) Composite Returns (IL-1023-C)-Application of ES Late Payment Penalty

No ES Late Payment penalty is imposed on any IL-1023-C return. IAC § 100.5140 Composite Returns: Estimated Payments

3. Penalty for Failure to Pay

For more information regarding the accrual of interest on UPIA penalties, refer to Interest on Penalties.

Each of the five subsections of UPIA regarding late-payment penalties are often referred to as UPIA 1 through 5, as they occur in chronological order. For example, the first, UPIA § 3-3(b) is informally referred to as "UPIA 1". Likewise, UPIA § 3-3(b-20) is informally referred to as "UPIA 5".

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a) Federal Changes (RARs)

UPIA § 3-3(b) penalties contain an exception to the late-payment penalty for amended returns, which are filed reporting the finalization of a federal change. In order for this exception to apply however, management policy requires that the amended return must be both filed and paid WITHIN 120 DAYS OF THE FEDERAL AUDIT FINALIZATION DATE. The exception will not apply if an additional liability is discovered relating to the RAR that the taxpayer neither reported nor paid to Illinois. The taxpayer would be subject to the UPIA late-payment penalty on the underreported and underpaid amounts.

Also, if an additional liability is discovered in audit that is not related to the RAR, but is processed along with the RAR, the late-payment penalty should be applied to the additional audit liability amount only.

> Example 1: Taxpayer timely reported an RAR increasing tax liability by $10,000. Auditor also discovered an additional audit liability for $2,000. The late-payment penalty would only be assessed on the additional audit liability of $2,000.
>
> Example 2: Taxpayer timely reported an RAR increasing tax liability by $10,000. Auditor discovered an additional liability of $2,000 related to the RAR that was not reported. The late-payment penalty would only be assessed on the additional RAR liability of $2,000.

If either of the UPIA late-payment penalties is applied to any tax year whose return is due prior to January 1, 2001, interest will accrue on the penalty from the original due date of the return (without extensions) until the date the penalty is paid, or until the date the notice and demand is issued, provided the total amount shown due on the notice and demand is paid within 30 days of issuance of the notice and demand.

For returns due prior to January 1, 2005, any payments made by the due date for payment must be taken into consideration in determining the amount of tax (basis) on which the late-payment penalty is to be calculated, even if some or all of the payments are refunded or credited as overpayments shown on the original return.

Refer to Exhibit E for the assessment of the Late-payment penalty on federal changes.

b) Returns Due On and After January 1, 2005 (UPIA § 3-3(b-20)(2)

(1) Penalty Rate

- 2%, if paid no later than 30 days after the due date,
- 10%, if paid later than 30 days after the due date and prior to the initiation of an audit,

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- 20%, if paid after the initiation of an audit, and
- Reduced to 15%, if the entire amount is paid not later than 30 days from issuance of IL-870

Due to the fact that the initiation of an audit causes the penalty to increase to 15% for any liabilities due after that date, the taxpayer must be notified in writing that an audit has been initiated. Refer to Chapter 20 Income Tax Audit Procedure for procedures on contacting the taxpayer.

Taxpayers filing a claim for refund after the completion of an agreed audit (other than from a Federal RAR change), the penalty will increase to 20% on the amount of the refund claim that is attributable to a late payment and is disallowed. The reduction in penalty from 20% to 15% is an incentive for the taxpayer to concede an audit liability, so the taxpayer cannot avoid the 20% penalty on a late payment by making the payment before the audit is competed and then filing a refund claim to contest the liability. Therefore, the day that we "issue" the IL-870 is very important as it starts the clock to determine the "completion date" of the audit.

The penalty on the IL-870 that is issued to the taxpayer should be calculated at 15%. You must explain to them that if they do not agree and pay within 30 days from the issue date on the IL-870, the penalty will be increased to 20%. If the taxpayer pays the tax within the 30-day period, but does not sign the IL-870, a tax payment constitutes agreement unless the taxpayer indicates that they are only paying the tax to stop the accrual of interest.

If the taxpayer indicates that they want to agree to a portion of the audit, the audit will be separated into agreed and unagreed issues. Two IL-870s will be issued. The IL-870 for the agreed portion will reflect a 15% penalty while the unagreed portion will be calculated at 20%.

(2) Penalty Basis

Tax shown or required to be shown on a return, reduced by any part of the tax which is paid on time and by any credit which was properly allowable on the date the return was required to be filed.

The "snapshot" rule does not apply to the UPIA § 3-3(b-20)(2) late-payment penalty. Overpayments on original returns that are refunded or credited as carryforwards reduce timely payments for the late-payment penalty basis.

(3) Assessment of the Penalty

Penalty is deemed assessed upon the assessment of the tax on which the penalty is based. If the penalty is assessed on an underpayment that is the result of a math error, EXECUTION OF AN IL-872 WILL NOT EXTEND THE

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STATUTE OF LIMITATIONS FOR ISSUING A NOTICE AND DEMAND FOR THIS PENALTY. Therefore, it is necessary to clearly indicate the statute expiration date for collecting the deemed assessed penalty in the Auditor's Comments.

c) Returns Due On and After January 1, 2004 and On or Before December 31, 2004 (UPIA § 3-3(b-15))

(1) Penalty Rate

- 2% of any amount that is paid no later than 30 days after the due date,
- 10% of any amount that is paid later than 30 days after the due date and not later than 90 days after the due date,
- 15% of any amount that is paid later than 90 days after the due date and not later than 180 days after the due date, and
- 20% of any amount that is paid later than 180 days after the due date.
-

(2) Penalty Basis

Tax shown or required to be shown on a return, reduced by any part of the tax which is paid on time and by any credit which was properly allowable on the date the return was required to be filed.

The fact that any of the payments might have later been refunded or credited to another tax year has no effect on the (b-15) penalty base. In order to determine the proper penalty base, a "snapshot" is taken of the payments and credits allowable as of the due date of the original return (without extensions).

Example: Corporation A filed its 11/30/2003 IL-1120 on 9/10/2004. The IL-1120 reflected a total tax liability of $120,000. The taxpayer made timely estimated payments totaling $150,000 for the year. They requested a $30,000 refund on their original return. The refund was mailed to the taxpayer in December 2004. An audit was completed on the 11/30/2003 return on 11/9/2005 which increased the total tax liability to $180,000. Since Corporation A had made $150,000 in estimated payments as of the due date of the return, the late-payment penalty would be calculated on $30,000. Therefore, the total penalty due per audit is $6,000 (30,000 x .20). This amount is entered in the Penalty section on the IL-870.

(3) Assessment of the Penalty

Penalty is deemed assessed upon the assessment of the tax on which the penalty is based. If the penalty is assessed on an underpayment that is the result of a math error, EXECUTION OF AN IL-872 WILL NOT EXTEND THE STATUTE OF LIMITATIONS FOR ISSUING A NOTICE AND DEMAND FOR

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THIS PENALTY. Therefore, it is necessary to clearly indicate the statute expiration date for collecting the deemed assessed penalty in the Auditor's Comments.

d) Returns Due On and After January 1, 2001 and On or Before December 31, 2003 (UPIA § 3-3(b-10)(1) and (2))

(1) Penalty Rate

(a) Admitted Liability (b-10)(1)

- 2% of any amount that is paid no later than 30 days after the due date,
- 5% of any amount that is paid later than 30 days after the due date and not later than 90 days after the due date,
- 10% of any amount that is paid later than 90 days after the due date and not later than 180 days after the due date, and
- 15% of any amount that is paid later than 180 days after the due date.

(b) Additional Liability (b-10)(2)

- 20% of any amount not paid within 30 days after a notice of math error, notice and demand, or a final assessment is issued by the Department.

(2) Penalty Basis

Tax shown or required to be shown on a return, whichever is applicable, or amended return (as adjusted for math errors) reduced by any part of the tax which is paid on time and by any credit which was properly allowable on the date the return was required to be filed.

If the amount of tax shown on the return is reduced, the penalty base is correspondingly reduced. REF: UPIA § 3-3(d).

This would include any reduction in tax due to the carryforward of an Illinois net loss, a federal net or capital loss or an Illinois Article 2 credit. However, the carryback of an Illinois net loss or federal capital loss WOULD NOT reduce the penalty base.

The fact that any of the payments might have later been refunded or credited to another tax year has no effect on the (b-10)(1) or (b-10)(2) penalty base. In order to determine the proper penalty base, a "snapshot" is taken of the payments and credits allowable as of the due date of the original return (without extensions).

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For additional (audit) liabilities, the (b-10)(2) penalty will not apply if the full amount of any tax is paid within 30 days after a notice of math error, notice and demand, or a final assessment is issued by the Department.

If both a (b-10)(1) and a (b-10)(2) penalty are assessed against the same return, the (b-10)(2) penalty will only be assessed against the additional amount of tax found due. REF: UPIA § 3-3(e-5).

Example 1(admitted liability): Taxpayer files its 2000 IL-1120 return on 3/15/2001 showing total tax due of $10,000 with timely estimated tax payments made of $4,000 (100% of last year's tax – no ES Late Payment Penalty due). The taxpayer shows a balance due on their return of $6,000 and pays the balance off by making the following payments.

Payment made on 4/10/2001	$1,000	$1,000 x 2% = $20
Amount paid no later than 30 days after the due date		
Payment made on 6/05/2001	$1,000	$1,000 x 5% = $50
Amount paid later than 30 days and not later than 90 days after the due date		
Payment made on 9/05/2001	$1,000	$1,000 x 10%= $100
Amount paid later than 90 days and not later than 180 days after the due date		
Payment made on 11/10/2001	$3,000	$3,000 x 15%= $450
Amount paid later than 180 days after the due date		
Total penalty due		= $620

Example 2 (audit liability): Taxpayer files their 2000 IL-1040 return on 4/15/2001 showing total tax due of $3,000, tax withheld of $2,800 and payment with the return of $200. On 6/10/2001 the Department notifies the taxpayer via a math error notice that their tax liability is underpaid by $300 due to a subtraction modification that is not allowed by the Department. The taxpayer pays the $300 plus interest on 7/18/2001. The penalty is $300 x 20% = $60. The $300 was not paid within 30 days from the date of the math error notice.

Example 3 (audit liability): Taxpayer files their 2000 IL-1120 return showing total tax due of $15,000 on 3/15/2001. The total tax was paid through timely payments of estimated tax. The Department audits the taxpayer in 2004 increasing the tax liability by $5,000. The taxpayer signs an IL-870 agreeing to the additional liability on 8/31/2004. The taxpayer makes a payment of $3,000 on 9/25/2004. On 10/20/2004, the taxpayer pays the remaining balance of $2,000 plus interest. The penalty is $2,000 x 20% = $400. The $2,000 was not paid within 30 days of the IL-870 signature date. (The penalty is only computed on the portion not paid within the 30-day period).

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(3) Assessment of the Penalty

(a) Admitted Liabilities (b-10)(1)

Penalty is deemed assessed upon the assessment of the tax on which the penalty is based. If the penalty is assessed on an underpayment that is the result of a math error, EXECUTION OF AN IL-872 WILL NOT EXTEND THE STATUTE OF LIMITATIONS FOR ISSUING A NOTICE AND DEMAND FOR THIS PENALTY. Therefore, it is necessary to clearly indicate the statute expiration date for collecting the deemed assessed penalty in the Auditor's Comments.

(b) Audit Liabilities (b-10)(2)

Allows the taxpayer certain time periods for paying any additional liability found due in an audit before any (b)(2) penalties will be applied. No (b)(2) penalty will be applied if the full amount of the additional TAX liability is paid:

- Within 30 days of the issuance of a notice and demand.
- Within 60 days of the date a Notice of Deficiency is issued IF THE NOTICE OF DEFICIENCY IS NOT PROTESTED WITHIN THE STATUTORY 60-DAY PROTEST PERIOD.
- Within 30 days from the date a final determination is issued on a protested liability.

IT IS IMPORTANT FOR THE AUDITOR TO FULLY EXPLAIN TO THE TAXPAYER THE REPERCUSSIONS OF AGREEING TO AN AUDIT AND SIGNING AN IL-870 AND NOT PAYING THE FULL AMOUNT OF TAX DUE PER AUDIT WITHIN 30 DAYS.

In order to avoid the (b-10)(2) penalty the taxpayer must pay the full amount of additional tax found due: however, that may not be the same tax amount upon which the (b-10)(2) penalty will be based if it is applied.

If a (b-10)(2) penalty is assessed on an additional liability found in audit it will be assessed through issuance of an income tax notice and demand by Springfield, not on an IL-870.

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e) Returns Due On and After January 1, 1998 and On or Before December 31, 2000 (UPIA 3-3 § (b-5)(1) and (2)

(1) Penalty Rate

- 20%

(2) Penalty Basis

Tax shown or required to be shown on a return, whichever is applicable, or amended return (as adjusted for math errors) reduced by any part of the tax which is paid on time and by any credit which was properly allowable on the date the return was required to be filed.

If the amount of tax shown on the return is reduced, the penalty base is correspondingly reduced. REF: UPIA § 3-3(d).

This would include any reduction in tax due to the carryforward of an Illinois net loss, a federal net or capital loss or an Illinois Article 2 credit. However, the carryback of an Illinois net loss or federal capital loss WOULD NOT reduce the penalty base.

The fact that any of the payments might have later been refunded or credited to another tax year has no effect on the (b-5)(1) or (b-5)(2) penalty base. In order to determine the proper penalty base, a "snapshot" is taken of the payments and credits allowable as of the due date of the original return (without extensions).

If both a (b-5)(1) penalty and a (b-5)(2) penalty are assessed against the same return, the (b-5)(2) penalty will only be assessed against the additional amount of tax found due. REF: UPIA § 3-3(e).

(3) Assessment of the Penalty

(a) Admitted Liabilities (b-5)(1)

Penalty is deemed assessed upon the assessment of the tax on which the penalty is based. If the penalty is assessed on an underpayment that is the result of a math error, EXECUTION OF AN IL-872 WILL NOT EXTEND THE STATUTE OF LIMITATIONS FOR ISSUING A NOTICE AND DEMAND FOR THIS PENALTY. Therefore, it is necessary to clearly indicate the statute expiration date for collecting the deemed assessed penalty in the Auditor's Comments.

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(b) Audit Liabilities (b-5)(2)

Allows the taxpayer certain time periods for paying any additional liability found due in an audit before any (b)(2) penalties will be applied. No (b)(2) penalty will be applied if the full amount of the additional TAX liability is paid:

- Within 30 days of the issuance of a notice and demand.
- Within 60 days of the date a Notice of Deficiency is issued IF THE NOTICE OF DEFICIENCY IS NOT PROTESTED WITHIN THE STATUTORY 60-DAY PROTEST PERIOD.
- Within 30 days from the date a final determination is issued on a protested liability.

IT IS IMPORTANT FOR THE AUDITOR TO FULLY EXPLAIN TO THE TAXPAYER THE REPERCUSSIONS OF AGREEING TO AN AUDIT AND SIGNING AN IL-870 AND NOT PAYING THE FULL AMOUNT OF TAX DUE PER AUDIT WITHIN 30 DAYS.

In order to avoid the (b-5)(2) penalty the taxpayer must pay the full amount of additional tax found due: however, that may not be the same tax amount upon which the (b-5)(2) penalty will be based if it is applied.

If a (b-5)(2) penalty is assessed on an additional liability found in audit it will be assessed through issuance of an income tax notice and demand by Springfield, not on an IL-870.

f) Returns Due On and After January 1, 1994 and On or Before December 31, 1997 (UPIA § 3-3(b)(1) and (2)

(1) Penalty Rate

- 15%

(2) Penalty Basis

Tax shown or required to be shown on a return, whichever is applicable, or amended return (as adjusted for math errors) reduced by any part of the tax which is paid on time and by any credit which was properly allowable on the date the return was required to be filed.

If the amount of tax shown on the return is reduced, the penalty base is correspondingly reduced. REF: UPIA § 3-3(d).

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This would include any reduction in tax due to the carryforward of an Illinois net loss, a federal net or capital loss or an Illinois Article 2 credit. However, the carryback of an Illinois net loss or federal capital loss WOULD NOT reduce the penalty base.

The fact that any of the payments might have later been refunded or credited to another tax year has no effect on the (b)(1) or (b)(2) penalty base. In order to determine the proper penalty base, a "snapshot" is taken of the payments and credits allowable as of the due date of the original return (without extensions).

Since the UPIA incorporates the ES Late Payment penalty rate into the (b)(1) late-payment penalty, if a taxpayer fails to make proper estimated payments AND fails to pay the total amount of tax due as of the due date of the original return without extensions, only one UPIA late-payment penalty can be applied to any dollar of unpaid tax liability.

> Example 1(admitted liability): Corporation A, a calendar year taxpayer, made timely estimated payments for 1993 of $500,000. On October 17, 1994, Corporation A filed its IL-1120 reporting a tax liability of $400,000. Corporation A requested that the $100,000 overpayment be credited to Corporation A's 1994 estimated payments.
>
> On July 1, 1995 A files an IL-1120-X increasing its 1993 tax liability to $550,000. In determining the amount of (b)(1) that applies to the amended return, the tax liability shown on the amended return ($550,000) is reduced by the amount of payments made by March 15, 1994 ($500,000). Although Corporation A owes an additional $150,000, Corporation A's (b)(1) penalty will be based on $50,000.
>
> Example 2 (admitted liability): Corporation A, a calendar year taxpayer, files its IL-1120 for 1993 on October 17, 1994 reporting a tax liability of $100,000. Corporation A submits payment for the entire $100,000 with the return. Assuming none of the exceptions or abatements for any of the penalties applied, a ES Late Payment penalty would be imposed on 90% of the tax liability and a (b)(1) penalty would be imposed on the remaining 10% of the liability.

However, for any payments made after the due date of the original return (without extensions), if the ES Late Payment penalty is not applied, the (b)(1) penalty can be applied. For instance, if the ES Late Payment penalty is not applied since:

- The tax liability shown on the return is less than the tolerance requiring estimated tax payments,

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- One of the exceptions to the ES Late Payment penalty apply (i.e. no return required in the previous year), or

- Reasonable cause abatement is warranted for the quarters involved,

then a (b)(1) penalty may be applied to the entire tax shown due and not paid by the date prescribed for payment.

Example 3 (admitted liability): Corporation A, a calendar year taxpayer, files its IL-1120 for 1993 on October 17, 1994 reporting a tax liability of $100,000. Corporation A submits payment for the entire $100,000 with the return. Corporation A was not required to file a return in Illinois for 1992. Even though an exception to the ES Late Payment penalty applies, Corporation A would be subject to a (b)(1) penalty on 100% of the tax liability shown due on the return since none of the tax was paid by the due date of the original return (without extensions).

If both a (b)(1) penalty and a (b)(2) penalty are assessed against the same return, the (b)(2) penalty will only be assessed against the additional amount of tax found due. REF: UPIA § 3-3(e).

Example 4 (audit liability): Corporation A, a calendar year taxpayer, made timely estimated payments of $50,000 for 1993. On October 17, 1994 Corporation A files a timely IL-1120 for 1993 reporting a tax liability of $110,000. Corporation A submits a payment of $60,000 with the original return. A notice and demand is issued to Corporation A for interest on tax, a (b)(1) penalty of $9,000 ($60,000 * 15%) and interest on the (b)(1) penalty. Corporation A pays the total amount shown due on the notice and demand.

In 1995 an audit is completed on Corporation A and adjustments are made which increase Corporation A's tax liability to $200,000. If a (b)(2) penalty is applied it will have a penalty base of $90,000; the amount required to be shown due on the return ($200,000) less any payments made by the due date of the original return without extensions ($50,000) less any tax which has had a (b)(1) penalty applied to it ($60,000).

The fact that any of the payments might have later been refunded or credited to another tax year has no effect on the (b)(1) or (b)(2) penalty base. In order to determine the proper penalty base, a "snapshot" is taken of the payments and credits allowable as of the due date of the original return (without extensions). The “snapshot” rule does not apply to UPIA-5.

Example 5 (audit liability): Corporation A, a calendar year taxpayer, made timely estimated payments for 1993 of $500,000. On October 17, 1994, Corporation A filed a timely IL-1120 reporting a tax liability of $400,000. A

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requested that the $100,000 overpayment be credited to Corporation A's 1994 estimated payments.

On July 1, 1995 an audit is completed on Corporation A and adjustments are made which increase Corporation A's 1993 tax liability to $550,000. In determining the amount of (b)(2) penalty that could apply to the audit liability, the tax liability established in audit ($550,000) is reduced by the amount of payments made by March 15, 1994 ($500,000). Although Corporation A owes an additional $150,000, any (b)(2) penalty will be based on $50,000.

In the case of a nonfiler, a ES Late Payment penalty and a (b)(2) penalty may not be applied against the same dollar of tax. If, however, a ES Late Payment penalty is not applied to any given quarter because:

- The tax liability required to be shown on the return is less than the tolerance requiring estimated tax payments,
- One of the exceptions to the ES Late Payment penalty apply (i.e. no return required in the previous year), or
- Reasonable cause abatement is warranted for the quarters involved,

a (b)(2) penalty may be applied to the entire tax required to be shown due and not paid by the date prescribed for payment.

Example 6 (audit liability): Corporation A, a calendar year corporation, is a nonfiler for Illinois income tax purposes for 1993. In 1995 an audit is conducted on Corporation A and a tax liability of $100,000 is established. If none of the exceptions to or abatements of the ES Late Payment penalty apply, a ES Late Payment penalty will be assessed on 90% of the audit liability ($90,000) and a (b)(2) may be assessed on the remaining 10% of the audit liability ($10,000).

If a ES Late Payment penalty does not apply to the audit liability since, for example, Corporation A was not required to file a return for the previous tax year, a (b)(2) penalty may be assessed on the entire audit liability ($100,000).

(3) Assessment of the Penalty

(a) Admitted Liabilities (b)(1)

Penalty is deemed assessed upon the assessment of the tax on which the penalty is based. If the penalty is assessed on an underpayment that is the result of a math error, EXECUTION OF AN IL-872 WILL NOT EXTEND THE STATUTE OF LIMITATIONS FOR ISSUING A NOTICE AND DEMAND FOR

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THIS PENALTY. Therefore, it is necessary to clearly indicate the statute expiration date for collecting the deemed assessed penalty in the Auditor's Comments.

(b) Audit Liabilities (b)(2)

Allows the taxpayer certain time periods for paying any additional liability found due in an audit before any (b)(2) penalties will be applied. No (b)(2) penalty will be applied if the full amount of the additional TAX liability is paid:

- Within 30 days of the issuance of a notice and demand.
- Within 60 days of the date a Notice of Deficiency is issued IF THE NOTICE OF DEFICIENCY IS NOT PROTESTED WITHIN THE STATUTORY 60-DAY PROTEST PERIOD.
- Within 30 days from the date a final determination is issued on a protested liability.

IT IS IMPORTANT FOR THE AUDITOR TO FULLY EXPLAIN TO THE TAXPAYER THE REPERCUSSIONS OF AGREEING TO AN AUDIT AND SIGNING AN IL-870 AND NOT PAYING THE FULL AMOUNT OF TAX DUE PER AUDIT WITHIN 30 DAYS.

In order to avoid the (b)(2) penalty the taxpayer must pay the full amount of additional tax found due: however, that may not be the same tax amount upon which the (b)(2) penalty will be based if it is applied.

If a (b)(2) penalty is assessed on an additional liability found in audit it will be assessed through issuance of an income tax notice and demand by Springfield, not on an IL-870.

4. Penalty for Failure to File Correct Information Return (UPIA § 3-4)

UPIA § 3-4(c) defines an information return as "any tax return required by a tax Act to be filed with the Department that does not, by law, require the payment of a tax liability".

The following forms are not information returns:

- IL-941 Illinois Withholding Income Tax Return
- ST-1 Sales and Use Tax and E911 Surcharge Return

Refer to IAC § 700.310(a) for examples of information returns.

Information returns are not required to be filed for the following types of income:

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- Certain payments made under contracts for personal services (IITA § 1405.2), and
- Certain payments of prizes and awards (IITA § 1405.3)

However, the UPIA § 3-4 penalty still applies if any person required to provide copies of information to persons to whom payments are made fails to do so.

a) Penalty Rate

- $5 will be assessed for each return or statement with respect to which the failure occurs, not to exceed $25,000 for all failures during any calendar year.

A reduction in the penalty of 50% ($2.50 or $12,500) will apply if any failure to file an information return or to include all of the information required to be shown on the return is corrected within 60 days after the required filing date.

Refer to IAC § 700.310(d)(3) & (4) for information on what constitutes a corrected information return and filing requirements.

b) Basis of the Penalty

The penalty for failure to file correct information returns will be imposed for the following failures:

- Any failure to file an information return with the Department on or before the required filing date, or

- Any failure to include all of the information required to be shown on the return or the inclusion of incorrect information.

5. Collection Penalty (UPIA § 3-4.5)

The collection penalty applies to any return due on or after July 1, 2003.

a) Penalty Rate

- $30 in any case in which the amount of the liability shown on the notice and demand, notice of additional tax due, or other request for payment that remains unpaid more than 30 days after the request for payment is issued is less than $1,000; or

- $100 in any case in which the amount of the liability shown on the notice and demand, notice of additional tax due, or other request for payment that

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remains unpaid more than 30 days after the request for payment is issued is $1,000 or more.

b) Basis of the Penalty

The collection penalty will be imposed if full payment is not received prior to the 31st day after a notice and demand, notice of additional tax due or a request for payment of a final liability is issued by the Department.

The collection penalty shall not be imposed more than once with respect to the liability for a particular tax for a given tax period.

Liability amount includes any related penalties and interest.

Reasonable Cause does not apply to the collection penalty.

Refer to IAC § 700.315(e) for examples regarding the collection penalty. [Note: this regulation has not yet been proposed.]

6. Penalty for Negligence (UPIA § 3-5)

UPIA § 3-5(a) states:

> If any return or amended return is prepared negligently, but without intent to defraud, and filed, in addition to any penalty imposed under UPIA § 3-3 of the Act, a penalty shall be imposed in an amount equal to 20% of any resulting deficiency.

If a UPIA § 3-5 penalty is applied to any tax year whose return is due prior to January 1, 2001, the penalty will accrue interest from the original due date of the return (without extensions) until the date the penalty is paid or until the date the notice and demand is issued, provided the total amount shown due on the notice and demand is paid within 30 days of issuance of the notice and demand. No interest accrues on this penalty for taxable years whose return is due on or after January 1, 2001.

For more information regarding the accrual of interest on UPIA penalties, refer to Interest on Penalties.

The negligence penalty can be assessed only by issuance of a notice of deficiency.

UPIA § 3-5(b) states that "negligence" includes any failure to make a reasonable attempt to comply with the provisions of any tax Act and includes careless, reckless or intentional disregard of the law or regulations.

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A reasonable difference as to taxability may be established by evidence that shows that the issue in dispute between the taxpayer and the Department is:

- Not resolved by the plain language of the statute.
- An issue about which the Department has not adopted a rule of general applicability.
- An issue about which the Illinois Supreme Court has not ruled and there are inconsistent opinions of the Illinois Appellate Courts. REF: IAC § 700.320.

It is improper to AUTOMATICALLY assess a negligence penalty against a taxpayer for failing to notify the Department of a change to their Federal Income Tax Return within 120 days (20 days prior to July 1, 1986) after the change becomes final. The negligence penalty may be asserted, however, in situations where an auditor has determined (from evidence gathered) that the taxpayer, in failing to notify the Department of a federal change, was guilty of negligence or an intentional disregard of the notification rules.

Negligence penalties cannot be assessed without approval from the Division Manager.

a) Penalty Rate

- 20% of any deficiency resulting from negligence on the part of the taxpayer, for returns due on and after January 1, 1994.

b) Basis of the Penalty

A negligence penalty can only be applied if a filed return (original or amended) is prepared negligently. UPIA § 3-5 PENALTY CANNOT BE APPLIED TO A DEFICIENCY ESTABLISHED ON A NONFILER.

For the UPIA § 3-5 penalty, a "deficiency" is the additional amount of tax determined by the auditor only if the return was filed timely. If the original return was filed after the extended due date, the full amount of tax due (i.e. the amount shown on the original return plus the additional amount established by audit) is the basis for the penalty. A taxpayer that is under audit will not be able to file amended returns during the course of the audit in order to avoid a negligence penalty. REF: IITA § 1002(f).

Example 1: For the calendar year 2012, a corporate taxpayer files a return on 10/10/2013. The original liability was $10,000 and taxpayer paid $9,000 in ES payments and $1,000 when the return was filed. Per audit it was determined that the taxpayer owes $35,000 resulting in a “deficiency” of $25,000. The negligence penalty is calculated on the $25,000 “deficiency.”

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Example 2: A corporation fails to file its income tax return for the year ending 12/31/2012. The taxpayer did file its 12/31/2011 return and requested that a $2,000 overpayment be carried forward and applied against the 12/31/2012 tax liability. Therefore, the taxpayer has "paid" $2,000 in tax for this year. Per audit it was determined that the taxpayer should have filed a return reporting a tax liability of $20,000 on the 12/31/2012 IL-1120. Since the corporation was a non-filer, the negligence penalty will not be assessed.

c) Assessment of the Penalty

The penalty for negligence is assessed through issuance of a Notice of Deficiency. The taxpayer has the right to protest the application of this penalty before payment is made. Because of this, the execution of an IL-872 extends the statute of limitations for assessment of the penalty. (IITA § 1002(e)).

7. Penalty for Fraud (UPIA § 3-6)

UPIA § 3-6 states,

> "(a) If any return or amended return is filed with intent to defraud, in addition to any penalty imposed under § 3-3 of this Act, a penalty shall be imposed in an amount equal to 50% of any resulting deficiency.
>
> (b) If any claim is filed with intent to defraud, a penalty shall be imposed in an amount equal to 50% of the amount fraudulently claimed for credit or refund."

If a UPIA § 3-6 penalty is applied to any tax year whose return is due prior to January 1, 2001, the penalty will accrue interest from the original due date of the return (without extensions) until the date the penalty is paid or until the date the notice and demand is issued, provided the total amount shown due on the notice and demand is paid within 30 days of issuance of the notice and demand. No interest accrues on this penalty for taxable years whose return is due on or after January 1, 2001.

The enactment of the UPIA had no effect on what constitutes fraudulent activity or on the assessment of the fraud penalty.

Fraud penalties cannot be assessed without approval from the Division Manager.

a) Penalty Rate

- 50% of any deficiency resulting from fraudulent activity or 50% of any refund claimed fraudulently, for returns due on and after January 1, 1994.

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b) Basis of the Penalty

A fraud penalty can only be applied if a filed return (original or amended) is prepared fraudulently. A UPIA § 3-6 PENALTY CANNOT BE APPLIED TO A DEFICIENCY ESTABLISHED ON A NONFILER.

As with the UPIA § 3-5 Negligence penalty, for purposes of the UPIA § 3-6 Fraud penalty, a "deficiency" is the additional amount of tax determined by the auditor only if the return was filed timely. If the original return was filed after the extended due date, the full amount of tax due (i.e. the amount shown due on the original return plus the additional amount established by audit) is the basis for the penalty. A taxpayer that is under audit will not be able to file amended returns during the course of the audit in order to avoid a fraud penalty. REF: IITA § 1002(f).

c) Fraudulent Activity

Refer to Audit Manual Chapter 20 Income Tax Audit Procedure for what constitutes fraudulent activity and the procedure for referring audit cases to the Criminal Investigation Division (CID).

8. Bad Check Penalty (UPIA § 3-7.5)

Effective January 1, 2001, a penalty of $25 shall be imposed on any person who issues a check or other draft to the Department that is not honored upon presentment. The penalty imposed under this Section shall be deemed assessed at the time of presentment of the check or other draft and shall be treated for all purposes, including collection and allocation, as part of the tax or other liability for which the check or other draft represented payment. This penalty can also qualify for reasonable cause under UPIA § 3-8.

9. Frivolous Return Penalty (IITA § 1006)

Effective for tax years ending on or after December 31, 1987, the frivolous return penalty applies to individual return filers only. The amount of the penalty, $500, is imposed upon any individual who files an IL-1040 which does not contain information needed to figure the correct tax or shows a substantially incorrect tax because the taxpayer is taking a frivolous position or are trying to delay or interfere with the collection of the tax. IAC § 100.5050(e) contains a list of positions considered frivolous which would subject the taxpayer to the penalty.

The penalty does not apply to an individual acting as a return preparer for another taxpayer or to an individual filing or signing a return of any taxpayer other than that individual.

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B. Interest

Refer to Publication 103, Penalties and Interest for Illinois Taxes, for additional explanation of penalties and interest assessed on returns due on or after January 1, 1994.

1. Assessment of Interest

Interest on tax is deemed assessed upon the late payment of tax.

For returns due on and after January 1, 2001, interest accrues on the amount of unpaid tax only (UPIA § 3-2(c-5).

Prior to January 1, 2001, if the UPIA penalty applied, the interest on the UPIA penalty applied.

There is no authority in the IITA to waive or abate interest. If the tax is found to be due, the interest is due.

Taxpayers who do not agree with the Department's determination of interest may file a claim for refund premised on an additional overpayment of interest due. The claim is to be filed in accordance with the provisions of IAC § 100.9400(c)(1) and 100.9400(f)(6).

2. Interest Computations

Interest is an amount which, in addition to tax and penalties, is due to the Department or refundable to the taxpayer. It is computed by the following formula:

Interest = Interest rate x period x amount of tax

For liability periods with original due dates which occur on or after January 1, 1994 and on or before December 31, 2000, interest is also computed on any penalties which are assessed in accordance with the Uniform Penalty and Interest Act.

For more information regarding the computation of interest on penalties, refer to Interest on Penalties.

3. Interest on Deficiencies

The interest period on a deficiency is not the same as the interest period on an overpayment. The object of assessing interest on underpayments of tax is to charge the taxpayer for using the funds beyond the date they should have been paid to Illinois. This is called the "use of money" theory. REF: Merten's Law of Federal Income Tax Section 55.02. Therefore, GENERALLY, interest on deficiencies is computed from the original due date of the return to the date paid, except in the following situations:

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- In an agreed audit liability (AL), IITA § 1003(a) gives the Department 30 days from the date Form IL-870 is filed with the Department to issue a Notice and Demand to the taxpayer. If the Notice and Demand is not issued within the 30 days, interest cannot be imposed from the 31st day after the IL-870 was issued to the date of the issuance of the Notice and Demand. In this situation, the auditor should process the audit to the supervisor within a maximum of seven days after the execution of the IL-870 for processing to Technical Review. The audit should be transmitted to Technical Review with a note explaining its priority: "AL - ISSUE NOTICE AND DEMAND PRIOR TO (the IL-870 date plus 30 days)."

  The waiver is considered "filed" on the date the taxpayer signs the IL-870. Therefore, the 30-day time period for issuance of the Notice and Demand begins at that point. Refer to Chapter 20 Income Tax Audit Procedure for more information regarding the processing of agreed audits without remittance.

- When an original return has been filed reflecting an overpayment, the start date for the accrual of interest on any subsequent liability varies depending on whether the taxpayer has requested that the overpayment be refunded or credited to the next year's estimated payments. Refer to the headings Original Overpayment Credited To Next Year's Payments, Original Overpayment Refunded Within 3 Months, Original Overpayment Not Refunded Within 3 Months, and Original Overpayment Refund Still Pending below.

The UPIA provisions may have an effect on the date on which interest stops accruing. UPIA § 3-2(c) and (c)(5) states:

> If notice and demand is made for the payment of any amount of tax due and if the amount due is paid within 30 days after the date of such notice and demand, interest under this Section on the amount so paid shall not be imposed for the period after the date of the notice and demand.

The "notice and demand" which is referred to in UPIA § 3-2(c) and (c-5) refers specifically to the Notice and Demand that is issued by Technical Review. An IL-870 is not a UPIA notice and demand, so interest will continue to accrue after the IL-870 is issued until the tax liability is paid.

At one time, the Form IL-870 was treated as a notice and demand, so that no interest would accrue on a liability shown on the Form IL-870 after the date it was issued if the liability was paid within 30 days. Taxpayers no longer have this 30-day grace period. For purposes of the Form IL-870, Auditors should continue to calculate interest through the IL-870 issuance date and explain to the taxpayer that additional interest will continue to accrue until the date the audit tax is paid. This is the postmark date for checks that are mailed to the Springfield office or the date the check is given to the Auditor. If the taxpayer wishes to avoid additional interest accruing, the taxpayer will need to pay the tax as of the IL-870 date.

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This does not affect the UPIA 5 late-payment penalty 30-day grace period. The taxpayer will still have 30 days from the issuance of the IL-870 to pay the audit tax before the late-payment penalty increases from 15% to 20%, as provided for in UPIA § 3-3(b-20)(2).

Example: Corporation A is a calendar year filer. As a result of an audit, which is conducted on the 2009 IL-1120, an additional audit liability of $5,000 is proposed. On September 1, 2011, at the close of the audit, the taxpayer is presented with an IL-870 reflecting tax due of $5,000 and interest (computed through September 1, 2011) of $118.63.

- The taxpayer signs the IL-870 and pays the TOTAL AMOUNT DUE of $5,118.63 on September 1, 2011. No additional interest accrues after September 1, 2011. (A UPIA § 3-3(b-20)(2) audit late-payment penalty at 15% would also apply in this situation.)

- The taxpayer signs the IL-870 on September 1, 2011. The taxpayer does not make a payment until October 10, 2011 when the full amount of tax is paid. Department issued a Notice and Demand on October 1, 2011. Since the TOTAL AMOUNT DUE was not paid on the execution date of the IL-870, the interest will continue to accrue from September 2 to September 30. Taxpayer owes an additional $15.89 of interest (interest on the $5,000 from September 2, 2011 until the date prior to the issuance of the Notice and Demand). (A (b-20)(2) audit late-payment penalty at 20% would also apply in this situation since the payment was made more than 30 days after the execution of the IL-870).

- The taxpayer signs the IL-870 on September 1, 2011. On September 11, 2011, the taxpayer pays $5,000. No other payment is made. Since the taxpayer did not pay the TOTAL AMOUNT DUE upon execution of the IL-870 taxpayer will owe the original interest amount of $118.63 (interest from March 15, 2011 to September 1, 2011 and an additional amount of interest from September 2, 2011 until the date of payment). (A (b-20)(2) audit late-payment penalty of 15% would also apply in this situation.)

- The taxpayer signs the IL-870 on September 15, 2011. On September 30, 2011, the taxpayer pays $5,118.63. Although the taxpayer paid the amount due as of October 1, 2011, regardless of the fact that the IL-870 was signed on September 15; interest continued to accrue until the liability was paid, which was September 30, 2011. Taxpayer owes additional interest accrued from September 1 to September 30 in the amount of $15.89. (A (b-20)(2) audit late-payment penalty of 15% would apply in this situation until October 1, 2011. If the remainder is paid after October 1, 2011 the rate will increase to 20%).

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a) Original Overpayment Credited to Next Year's Payments

The following information applies ***only*** to the computation of interest on a subsequent liability established in a year in which the taxpayer has requested that an overpayment be applied to next year's return as an estimated tax payment.

These procedures are based on the hearing decision in Proctor & Gamble (95-IT-0037) and the federal court case in May Department Stores Co. (36 Fed. Cl. 680 (1996), acq. AOD CC:1997-008 (Aug. 4, 1997)).

When an overpayment is applied to a subsequent year, the Department **always** applies it to the first estimated tax installment (for tax year 12/31/2013 and prior. For tax years 2014 and after credit carryforwards are applied to the tax period for which estimated payments currently are due as of the date the return is filed, unless an election is made to apply the credit to a different tax year. If the return is filed on or before the extended due date, the credit is considered paid on the due date of the first estimated tax installment of the tax period. However, if all or a portion of the overpayment results from payments made after the due date of the first estimated tax installment, that portion of the credit is considered to be paid on the date the payment was actually made. If the return is filed after the extended due date, that credit is considered paid on the file date of the return that made the election).

When a taxpayer has requested that an overpayment shown on their original return, be applied to their next year's estimated payments, the interest computed on that portion of any subsequent liability should be computed from the earlier of:

1. The date the credit was needed to satisfy the estimated payment requirement for the succeeding year, or

2. The date the overpayment year return was filed.

If an **increase in tax liability** is established for the overpaid year (year 1) ***due to an audit or the filing of an amended return***, interest on the portion of the liability that is ***less than or equal to*** the original credit carryforward amount to year 2 will be computed according to the following steps:

1. Did the taxpayer file the return for year 1 on or before the due date of the first estimated tax installment for year 2? *If yes, interest begins to accrue from the day after the due date of the first installment for year 2. If no, go to step 2*.

2. Was any portion of the year 1 credit carryforward needed to satisfy any part of the first estimated tax installment for year 2 in order to avoid ES Late Payment penalty? *If yes, interest begins to accrue on that portion from the day after the due date of the first installment for year 2. If no, go to step 3*.

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3. Was there any excess portion of the credit carryforward that was not needed to satisfy the first estimated tax installment for year 2? If no, stop here. If yes, go to step 4.

4. Did the taxpayer file the return for year 1 before the due date of the second estimated tax installment for year 2? *If yes, interest will begin to accrue on the portion of the credit carryforward that was not needed in step 2 from the day after the date the return was filed. If no, go to step 5*.

5. Was any excess portion of the credit carryforward in step three needed to satisfy any part of the second estimated tax installment for year 2 in order to avoid ES Late Payment penalty? *If yes, interest begins to accrue on that portion from the day after the due date of the second installment for year 2. If no, go to 6*.

6. Was there any excess portion of the credit carryforward that was not needed to satisfy the first and second installments for year 2? If no, stop here. If yes, go to 7.

7. Did the taxpayer file the return for year 1 before the due date of the third estimated tax installment for year 2? *If yes, interest will begin to accrue on the portion of the credit carryforward that was not needed in steps 2 and 5 from the day after the date the return was filed. If no, go to 8*.

8. Was any excess portion of the credit carryforward in steps 3 and 6 needed to satisfy any part of the third estimated tax installment for year 2 in order to avoid ES Late Payment penalty? *If yes, interest begins to accrue on that portion from the day after the due date of the third installment for year 2. If no, go to 9*.

9. Was there any excess portion of the credit carryforward that was not needed to satisfy the first, second and third installments for year 2? If no, stop here. If yes, go to 10.

10. Did the taxpayer file the return for year 1 before the due date of the fourth estimated tax installment for year 2? *If yes, interest will begin to accrue on the portion of the credit carryforward that was not needed in steps 2, 5 and 8 from the day after the date the return was filed. If no, go to 11.*

11. Was any excess portion of the credit carryforward in steps 3, 6 and 9 needed to satisfy any part of the fourth estimated tax installment for year 2 in order to avoid Section ES Late Payment penalty? *If yes, interest begins to accrue on that portion from the day after the due date of the fourth installment for year 2. If no, go to 12*.

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12. Was there any excess portion of the credit carryforward that was not needed to satisfy the first, second, third and fourth installments for year 2? If no, stop here. If yes, go to 13.

13. *Interest begins to accrue on that portion from the day after the date the return was filed*.

Example 1: Company ABC files their original return for calendar year 1 on 10/15/x2. The return reflects total tax due of $20,000. The taxpayer makes estimated tax payments in the amount of $30,000, which results in an overpayment of tax in the amount of $10,000. Company ABC indicates on their return that they want the overpayment of $10,000 applied to their estimated tax payments for year 2. The year 1 overpayment of $10,000 is applied to the first estimated tax installment period for year 2 on 4/15/x2.

Company ABC made estimated tax payments for year 2 (based on 100% of the tax paid in year 1) totaling $20,000. The taxpayer used the $10,000 credit from year 1 and made two $5,000 ES payments, which were for the first and second quarter installments.

Payments & Credits

$10,000 on 4/15/x2	(ES Pmt – Credit from year 1)
$5,000 on 4/15/x2	(ES Pmt)
$5,000 on 6/15/x2	(ES Pmt)
$-0- on 9/15/x2	
$-0- on 12/15/x2	

An audit is completed on year 1 and it is determined that Company ABC had understated their tax liability by $8,000. ***For purposes of computing interest on the year 1 liability***, we treat the credit as being applied to whatever period the money is needed to satisfy a particular installment. In this case, it was the third and fourth quarter installments since the taxpayer did not make estimated tax payments for these.

Interest on the $8,000 will be computed as follows:

1. Interest on $5,000 will be computed from 9/16/x2 (the day after the due date of the third installment payment for year 2), and

2. Interest on $3,000 will be computed from 10/16/x2 (the day after the date the year 1 return was filed).

Example 2: Same as Example 1, except Company ABC's estimated tax payments are made on different dates. The taxpayer used the $10,000

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credit from year 1 and made two $5,000 ES payments, which were for the third and fourth quarter installments.

Payments & Credits
$10,000 on 4/15/x2 (ES Pmt – Credit from year 1)
$-0- on 4/15/x2
$-0- on 6/15/x2
$5,000 on 9/15/x2 (ES Pmt)
$5,000 on 12/15/x2 (ES Pmt)

In this example, we would treat the credit as being applied to the first and second installments, since the taxpayer did not make estimated payments for these.

1. Interest on $5,000 will be computed from 4/16/x2 (the day after the due date of the first installment payment for year 2), and

2. Interest on $3,000 will be computed from 6/16/x2 (the day after the due date of the second installment payment for year 2).

Example 3: Same as Example 1, except Company ABC understated their tax liability by $15,000. Interest on the $15,000 will be computed as follows:

1. Interest on $5,000 will be computed from 3/16/x2 (the day after the due date of the year 1 return).

2. Interest on $5,000 will be computed from 9/16/x2 (the day after the due date of the third installment payment for year 2).

3. Interest on $5,000 will be computed from 10/16/x2 (the day after the date the year 1 return was filed.)

Example 4: Same as Example 2, except Company ABC understated their tax liability by $15,000. Interest on the $15,000 will be computed as follows:

1. Interest on $5,000 will be computed from 3/16/x2 (the day after the due date of the year 1 return.

2. Interest on $5,000 will be computed from 4/16/x2 (the day after the due date of the first installment payment for year 2), and

3. Interest on $5,000 will be computed from 6/16/x2 (the day after the due date of the second installment payment for year 2).

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b) Original Overpayment Refunded Within 3 Months

When a taxpayer has requested that an overpayment appearing on an original return be refunded, AND the refund was issued within 3 months from the last date prescribed for filing the return or from the date the return was filed whichever is later (therefore, no interest was paid on the overpayment), interest on that portion of any subsequent deficiency should be computed from the date the refund was issued.

Example: Company A makes timely estimated payments totaling $30,000 for the 1988 calendar tax year. On October 15, 1989 Company A files a tax return reporting a liability of $20,000 and requesting that the overpayment of $10,000 on the original return be refunded. The refund was issued on December 15, 1989. In 1990, Company A is audited for 1988 and a deficiency of $25,000 is proposed. Interest on $15,000 ($25,000 - $10,000) of the deficiency would be computed from the March 16, 1989 through December 14, 1989 and on $25,000 from December 15, 1989 to the date of payment.

REF: IRS Rev. Ruling 88-98.

c) Original Overpayment Not Refunded Within 3 Months

When a taxpayer has requested that an overpayment appearing on an original return be refunded AND the refund is not issued within the 3-month time period described above, interest on that portion of any subsequent deficiency should be computed from the date of overpayment.

Example: Company A makes timely estimated payments totaling $30,000 for the 1988 calendar tax year. On October 15, 1989 Company A files a tax return reporting a liability of $20,000 and requesting that the overpayment of $10,000 on the original return be refunded. The refund (consisting of the tax and interest on the $10,000, computed from October 15, 1989) was issued on June 30, 1990. In 1990, Company A is audited for 1988 and a deficiency of $25,000 is proposed. Interest on $15,000 ($25,000 - $10,000) of the deficiency is computed from March 16, 1989 through October 14, 1989, on $25,000 from October 15, 1989 to the date of payment and on the interest paid on the refund starting from June 30, 1990 to the date of payment.

d) Original Overpayment Refund Still Pending

When a taxpayer has requested that an overpayment appearing on an original return be refunded AND the refund is still pending, interest on a subsequent deficiency is only computed on the amount, if any, by which the deficiency exceeds the amount of the pending refund.

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Example: Company A makes timely estimated payments totaling $30,000 for the 1988 calendar tax year. On October 15, 1989 Company A files a tax return reporting a liability of $20,000 and requesting that the overpayment of $10,000 on the original return be refunded. The refund is currently pending. In 1990, Company A is audited for 1988 and a deficiency of $25,000 is proposed. No interest would be computed on $10,000 of the deficiency. Interest on the remaining $15,000 would be computed from the March 16, 1989 to the date of payment.

4. Interest on Overpayments

An overpayment is any creditable or refundable portion of taxes, penalty or interest that was previously paid. This means that an overpayment of tax includes any paid previously assessed penalties and interest related to the overpaid tax.

If, in the course of an audit, it is determined that an overpayment of tax exists for a reason other than a federal capital loss, net operating loss carryback or an Illinois net loss carryback, the overpayment will include any refundable penalties and any interest assessed on tax or on penalties under UPIA § 3-2. REF: IAC § 100.9400(c)(2). If an audit reduces a taxpayer's income tax liability which has been paid along with a UPIA § 3-3(b), (b-5), (b-10), (b-15) and (b-20) assessable penalty and interest, the overpayment (upon which interest is computed) includes the amount of the reduction in penalty and underpayment interest attributable to the reduction in tax. For UPIA liability periods the term "overpayment" would also include any interest previously paid on penalties.

The ES Late Payment penalty, which is based on the amount of tax "shown on the return" IS NOT REDUCED OR INCREASED by any subsequent action that alters the tax liability.

The carryback of a federal capital loss or net operating loss or an Illinois net loss will not reduce any previously imposed penalties.

Example: Corporation Z files its December 31, 2008 IL-1120 on November 6, 2009 and pays tax with the return in the amount of $5,000, UPIA-5 (§ 3-3(a-10)) late-filing penalty in the amount of $100, UPIA-5 (§ 3-3 (b-20)) late-payment penalty in the amount of $500 and interest in the amount of $46.99 through November 6, 2009. During the course of an audit, the auditor determines that the taxpayer has overpaid its tax liability by $2,400. In addition to the $2,400 tax refund, Corporation Z will also receive a refund of the late-filing penalty, late-payment penalty and interest previously paid on the $2,400 of $48, $240 and $22.55, respectively, for a total overpayment amount of $2,710.55.

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a) Date of Overpayment

(1) The date or dates of overpayment, except in the case of a federal change due to the final allowance of a carryback from a loss year ending prior to December 31, 1986, are the date of payment of the first amount that (when added to previous payments) exceeds the tax liability (including interest or penalties) for the taxable year and the date or dates of any subsequent payments made with respect to the tax liability.

There can be no overpayment of tax until the LATER of the following three situations occurs (REF: IAC § 100.9400(c)(3)):

- The last day prescribed for filing the return. (The original due date).

  Example: Corporation Q is a calendar year filer for 2008. The statutory due date is March 15, 2009. Corporation Q files its annual return on March 1, 2009. The taxpayer has made excess estimated payments of $2,000. The taxpayer is sent a refund on September 11, 2009. Interest would be computed from March 16, 2009 even though the tax was paid prior to that date.

- The date the original return (IL-1120) is actually filed for the taxable year.

  Example 1: Corporation K files its December 31, 2006 IL-1120 on September 14, 2007 showing a total tax liability of $25,000. Corporation K has made estimated payments in the amount of $15,000 and paid tax in the amount of $10,000 with the return. In 2009, Corporation K files an IL-1120X to report a federal RAR, which reduces its Illinois income tax liability by $12,000. Interest is computed on the refund from the date the original return was filed (September 14, 2007) to the date that the refund is made.

  Example 2: Corporation B files a tentative return (IL-505-B) for the year ending December 31, 2007 on March 15, 2008. The taxpayer receives an automatic extension of time until October 17, 2008. A final return is filed on August 15, 2008. The date of overpayment will be August 15, 2008.

  Prior to the December 28, 1982 revisions to the IAC § 100.9400, the date the return was actually filed was not a criteria in determining the date of the overpayments.

- The date that the entire tax liability due for the taxable year is satisfied.

  Example: Corporation X is a calendar year filer for 2007 and pays $10,000 tax with its original return on March 15, 2008, the statutory due date of the return. Corporation X realizes that it made an error in its original filing and files an IL-1120-X on October 17, 2008 paying additional tax in the amount of $5,000 plus

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interest of $88.49. Corporation X is audited by the Department and the auditor establishes an overpayment of tax of $2,500 on January 12, 2010.

DATE	ADJUSTMENT	TOTAL TAX
03/15/2008	Filed original return	$10,000
10/17/2008	IL-1120-X $5,000	$15,000
01/12/2010	Audit ($2,500)	$12,500

The date from which interest is calculated on the overpayment is October 17, 2008. If not for the additional tax payment of $5,000 on that date, the taxpayer would not be overpaid; hence, the date of the overpayment is October 17, 2008.

The amount of the overpayment is the $2,500 of tax that was overpaid as of October 17, 2008 plus the accompanying interest of $44.25 which was also paid on October 17, 2008 for a total overpayment amount of $2,544.25. REF: IAC § 100.9400(c)(2). Interest would be computed from October 17, 2008 through the date the refund was issued on an overpayment of $2,544.25.

If the amount of overpayment of tax established in audit was $7,000, then there would have been two interest start dates. Interest on $5,000 of tax plus the $88.49 of previously paid interest would have been computed from October 17, 2008. Interest on the remaining $2,000 would have been computed from March 15, 2008, which was the date the original return was filed and the $10,000 tax was paid.

(2) In the case of a federal change due to the final allowance of a carryback from a loss year ending prior to December 31, 1986, the date of overpayment shall be:

a. The close of the taxable year in which the deduction, losses, or other item or event occurred that created the federal carryback

b. Or, the date when the return for the carryback year is filed, whichever is later.

(3) In the case of a federal change due to the final allowance of a carryback or carryforward from a loss year ending on or after December 31, 1986, and in the case of an Illinois change due to the carryforward or carryback of an Illinois net loss, Illinois investment credit, jobs credit, replacement tax credit, or other credit (other than estimated or tentative tax credit) from a loss or credit year ending on or after December 31, 1986, the date of overpayment shall be:

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a. The date the claim for refund is filed, except, that if any overpayment is refunded within 3 months after the date the claim for refund is filed, no interest shall be allowed on the overpayment.

b. Beginning January 1, 1994, if a claim for refund relates to an overpayment attributable to a net loss carryback as provided by IITA § 207, the date of overpayment shall be the last day of the taxable year in which the loss was incurred.

Example: ABC filed a timely IL-1120 for 1989 reflecting income of $50,000. Corporation ABC filed a timely IL-1120 for calendar year 1992 reflecting an Illinois net loss of $100,000. On December 13, 1993 ABC filed an IL-1120-X carrying back its 1992 INLD to 1989 and requesting a refund of overpaid taxes.

In April of 1994, the IL-1120 for 1992 and the IL-1120-X for 1989 are audited and it is determined that ABC actually incurred an Illinois net loss of $80,000 in 1992. An IL-870 is prepared reflecting the approved refund for 1989 and the comments section of the IL-870 will state that the IL-870 is reflecting a partial denial of the claim which was filed December 13, 1993.

Since the Illinois net loss carryback claim was filed before January 1, 1994, IAC § 100.9400(c)(3)(C) applies and the date of overpayment is the date the claim is filed. If, however, the taxpayer formally withdrew the December 13, 1993 claim and used the IL-870 as an original claim to carryback the 1993 Illinois net loss, the claim would be considered "filed" as of the date the taxpayer signed the IL-870. Since this date would be after January 1, 1994, IAC § 100.9400(c)(3)(D) would apply and the date of overpayment for the Illinois net loss claim would be the end of the loss year.

b) Period for which interest is allowable

On and after January 1, 1994, interest on amounts refunded or credited pursuant to the filing of an amended return or claim for refund shall be determined from the due date of the original return or the date of overpayment, whichever is later, to the date of payment by the Department.

Prior to January 1, 1994, interest shall be allowed and paid from the date of overpayment to a date determined by the Director or his or her designee, which shall not be more than 30 days prior to the date of any refund or credit.

No interest shall be paid to a taxpayer on any refund allowed under the Tax Delinquency Amnesty Act.

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According to Public Act 98-925 (requiring us to allow taxpayers to elect to apply overpayments against estimated tax on late returns and amended returns):

- In the case of a timely-filed original return on which the taxpayer elects to have some or all of the overpayment applied to the following year's estimated tax obligation, no interest is allowed on the amount applied.

- On a late-filed original return or an amended return, interest accrues on the amount applied against estimated tax under principles that otherwise apply to refund but cannot accrue after the filing date of the return or amended return on which the election is made.

c) For Refund Claims Filed On or After January 1, 1994

The date of overpayment will be as detailed in IAC § 700.230(b) as follows:

The date of overpayment means:

- The date the tax was paid,

- The original due date of the return, or

- The date a processable return was received, whichever is later.

EXCEPT IN THE FOLLOWING SITUATIONS:

- If a claim for refund is filed that is the result of an Illinois net loss carryback, the date of overpayment is the last day of the loss year. REF: UPIA § 3-2(d)

- If a claim for refund is filed resulting from the carry back of a federal net operating loss or a capital loss, the date of overpayment shall be the date the claim for refund is filed (or the date an IL-870 is issued). IAC § 100.9400(c)(3)(C)

No interest will be paid upon any overpayment of tax if the overpayment is refunded within 90 days after the due date of the original return, or within 90 days of receipt of a processable return or within 90 days of the date of overpayment, whichever is later.

For more information regarding processable and unprocessable returns refer to Unprocessable Returns.

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d) Refunds Resulting from Carryforwards and Carrybacks

There are currently 8 possible dates of overpayment contained in IAC § 100.9400:

- In the case of a claim being filed to carryback a pre-86 Federal net operating loss or a Federal capital loss, the date of overpayment is the last day of the loss year or the date the final return is filed for the carryback year, whichever is later. REF: IAC § 100.9400(c)(3)(B).

- In the case of a claim being filed to carryforward a pre-86 Federal net operating loss or a Federal capital loss, the date of overpayment is the latter of the original due date of the return (without extensions) for the carryforward year, the date the payment was made which created the overpayment in the carryforward year or the date the return for the carryforward year was filed. REF: IAC § 100.9400(c)(3)(A).

In the case of a carryforward year with an original due date (without extensions) for the return which occurs on or after January 1, 1994, the final criteria listed above would be the date a processable return was filed for the carryforward year.

- In the case of a claim being filed to carry a Federal capital loss which is incurred in a tax year ending on or after 12/31/86 either forward or back, the date of overpayment is the date the claim is filed. If the refund is issued within 3 months of the date the claim is filed, no interest is paid. REF: IAC § 100.9400(c)(3)(C).

- In the case of a claim being filed to carryback an Illinois net loss, IF THE CLAIM IS FILED PRIOR TO JANUARY 1, 1994, the date of overpayment is the date the claim was filed. If the refund is issued within 3 months of the date the claim is filed, no interest is paid. REF: IAC § 100.9400(c)(3)(C).

- In the case of a claim being filed to carryback an Illinois net loss, IF THE CLAIM IS FILED ON OR AFTER JANUARY 1, 1994, the date of overpayment is the end of the loss year. REF: IAC § 100.9400(c)(3)(D).

- In the case of a claim being filed to carryforward an Illinois net loss, the date of overpayment is the date the claim is filed. If the refund is issued within 3 months of the date the claim is filed, no interest is paid. REF: IAC § 100.9400(c)(3)(C).

- In the case of a claim being filed to carryforward an Illinois credit from a credit year which ended prior to 12/31/86, the date of overpayment is the later of the original due date of the return (without extensions) for the carryforward year, the date the payment was made which created the overpayment in the carryforward year or the date the return for the carryforward year was filed. REF: IAC § 100.9400(c)(3)(A).

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In the case of a carryforward year with an original due date (without extensions) for the return which occurs on or after January 1, 1994, the final criteria listed above would be the date a processable return was filed for the carryforward year.

- In the case of a claim being filed to carryforward an Illinois credit from a credit year which ended on or after 12/31/86, the date of overpayment is the date the claim was filed. If the refund is issued within 3 months of the date the claim is filed, no interest is paid. REF: IAC § 100.9400(c)(3)(C).

If the taxpayer has filed a claim for refund, any audit adjustments to the claim which decrease the overpayment should be clearly identified on the IL-870 as either a total or partial denial of the originally filed claim. UNLESS THE TAXPAYER HAS OFFICIALLY WITHDRAWN THE CLAIM AND THE CLAIM IS NOW BEING ESTABLISHED IN AUDIT (CL), THE IL-870 IS NOT SUPERSEDING OR REPLACING THE ORIGINALLY FILED CLAIM. If an originally filed claim is being increased in audit, the signed IL-870 is considered the taxpayer's claim for the additional overpayment amount.

Example: Corporation A files a timely IL-1120 for 1992 reflecting an Illinois Net Loss Deduction (INLD) of $200,000. In December of 1993, Corporation A files an IL-1120-X for 1989 carrying the INLD back to offset income in that year and requesting a refund. Interest on the refund would begin on the date the claim was filed (assuming the refund was not paid within 3 months of the date of claim).

In March of 1994, an audit is conducted on the 1992 return and the 1989 claim. It is determined that an incorrect Illinois Net Loss was claimed in 1992. The amount of refund requested is correspondingly reduced. The taxpayer agrees with the audit results and signs the IL-870, which reflects the reduced refund amount on March 31, 1994.

Since the IL-870 is denying a portion of the originally filed claim, the date of overpayment for the reduced amount of refund is still the date the original claim was filed. If, however, the taxpayer had formally withdrawn the claim and stated that the IL-870 would serve as the originally filed claim carrying back the correct amount of INLD, the date the IL-870 was signed would be considered the date of claim. Since the IL-870 was signed on or after January 1, 1994, the UPIA restricted interest provisions would be in effect and the date of overpayment for the INLD carryback would be the end of the loss year (December 31, 1992).

In audits involving normal audit deficiencies or overpayments and restricted interest overpayments, it is necessary to include an EDA-25, Auditor's Report, FOR EACH SITUATION, which identifies the amount of liability or overpayment and the

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appropriate interest amounts. The multiple EDA-25s are necessary for processing purposes.

The following paragraphs detail some of the restricted interest situations that are often encountered in audit.

All of the examples contained in the following paragraphs assume:

- The taxpayers have calendar year tax years.
- The term "credits" refers to the Article 2 credits which are available. The term, as it is used below, does not include estimated or tentative payment credit carryforwards from an original return.
- No credits or refunds were issued on the original returns.
- All original returns were timely filed.
- All refunds were issued more than 90 days after the date the claim was filed.
- The "date the refund is issued" is the “Posted” date on the Transaction tab in GenTax (or the warrant request (REQ) date, which appeared on the Taxpayer History Report in the BIT system).
- Illinois tax amounts are not intended to be mathematically accurate but rather are used to illustrate the interest computation principles involved.
- The terms “pre-loss” and “pre-credit” refer to the audit liability that exists if the loss or excess credit carryforward is not taken into consideration.
- The term “original due date” refers to the due date of the return without regard to extensions.

e) Illinois Net Loss/Credit C/F on Original Return

When an Illinois net loss or credit is carried forward on an original return, no interest will accrue on the tax liability which would have been incurred on that original return had there been no Illinois net loss or credit to carry forward. An UNDERPAYMENT of tax on the original return is determined based on the amount that was required to be shown as tax on the original return, reduced by the amount of any credit against the tax which was properly allowable ON THE DATE THE RETURN WAS REQUIRED TO BE FILED.

Example: Corporation A incurred an Illinois net loss for 1989. On 10/15/91 Corporation A filed a timely IL-1120 for 1990 carrying forward the 1989 Illinois net loss and completely offsetting any 1990 tax liability. No interest would

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accrue on any unpaid "pre-loss" liability for 1990 for the period of 3/15/91 to 10/15/91. Interest on any overpayment will begin to accrue as of 10/15/91, the date the return was filed.

f) Illinois Net Loss/Credit Carried on Amended Return

When an Illinois net loss or credit is carried forward on an amended return or carried back on an amended return filed prior to January 1, 1994, the provisions of IAC § 100.9400(c)(3)(C) would apply. This section states that for post-12/31/86 net operating loss carrybacks (if the claim is filed prior to January 1, 1994) or carryforwards, the date of overpayment for calculating interest on the resulting overpayments is the date the claim is filed.

Example 1: For 1989, Corporation A incurs an Illinois net loss. On 2/1/92, Corporation A files a claim for refund carrying back the 1989 Illinois net loss to 1986. Interest on the resulting overpayment will be calculated from the date the claim was filed (2/1/92) through the date the refund is issued.

Example 2: For the year ended 1989, Corporation A incurs an Illinois net loss of $1 million. On 10/15/91, Corporation A files an IL-1120 for 1990 and does not carry the 1989 loss forward. The 1990 original return reflects a tax liability of $10,000. Corporation A has made payments in the amount of $6,000 and has an outstanding tax balance on the original return of $4,000. On 11/20/92, Corporation A files an IL-1120-X for 1990, carrying forward the 1989 Illinois net loss and reducing the tax liability for 1990 to $-0-.

Interest will accrue on the unpaid, original return, liability of $4,000 from the due date of the original return without extensions (3/15/91) to the date the claim was filed (11/20/92). Once the 1989 Illinois net loss is carried forward, interest on the net overpayment of $6,000 is calculated from the date the claim was filed through the date the refund is issued.

If an Illinois net loss is carried back on an amended return which is filed on or after January 1, 1994, the date of overpayment is the last day of the loss year.

Example 3: For the year ended 1992, Corporation A incurs an Illinois net loss which Corporation A carries back to 1989 on an amended return filed February 2, 1994. Interest on the resulting refund is computed from the end of the loss year (12/31/92) through the date the refund is issued.

g) Illinois Net Loss/Credit Carried in Audit

Prior to January 1, 1994, when no claim has been filed to carry the Illinois net loss either back or forward or an Illinois credit forward and the Illinois net loss or credit is carried in audit, the "date of overpayment" for any resulting refund would be the date the IL-870 is signed since, in this situation, the IL-870 is considered the claim. REF:

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Form IL-870. IF THE TAXPAYER DOES NOT AGREE WITH THE AUDIT RESULTS AND SIGN THE IL-870, THE LOSSES CANNOT BE CARRIED IN AUDIT. THE AUDITOR SHOULD ESTABLISH THE AUDIT LIABILITY WITHOUT TAKING ANY LOSS OR CREDIT CARRYOVERS INTO CONSIDERATION. THE TAXPAYER WILL THEN BE RESPONSIBLE FOR FILING AMENDED RETURNS CARRYING THE LOSSES OR CREDITS.

Example 1: For 1989, Corporation A incurs an Illinois net loss. An audit is conducted on the period covering tax years 1987 through 1989. In the audit, it is realized that taxpayer has never carried the 1989 Illinois net loss to an income year and it is agreed that the loss should be carried back to 1986. Taxpayer signs the IL-870 (reflecting the overpayment resulting from the Illinois net loss carryback to 1986) on 6/15/91. Interest on the refund will begin to accrue on the date of overpayment (i.e. the date the IL-870 was signed - 6/15/91).

Example 2: For 1986, Corporation A incurred an Illinois net loss, which had never been carried. An audit is conducted on the period of 1986 through 1989 and, it is agreed that the Illinois net loss will be carried forward to offset income in 1987. Corporation A signs the IL-870 (which reflects the overpayment resulting from the Illinois net loss carryforward to 1987) on 6/15/91. Interest on the refund will begin to accrue on the date of overpayment (i.e. the date the IL-870 was signed - 6/15/91).

On or after January 1, 1994, if a taxpayer does not file a claim carrying back an Illinois net loss and the loss is carried back in audit, interest on the resulting refund will begin to accrue on the last day of the loss year.

Example 3: For 1992, Corporation A incurred an Illinois net loss, which had never been carried. An audit is conducted on the period of 1989 through 1992 and it is agreed in audit that the 1992 Illinois net loss should be carried back to offset income in 1989. The IL-870 is signed by the taxpayer on March 20, 1994 and reflects an overpayment for 1989 based on the Illinois net loss carryback. Interest on the 1989 overpayment will accrue from the end of the loss year (12/31/92) through the date the refund is issued.

For additional examples on calculating interest refer to Chapter 43 GenTax Penalty and Interest Calculator Exhibits.

h) For Refund Claims Filed Prior to January 1, 1994

The date of overpayment is the date of payment of the tax that is determined to be overpaid. However, there can be no overpayment prior to the due date of the return, the date the return was filed or the date the tax liability is satisfied whichever is later. This applies to both original and amended returns with two exceptions:

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1. In the case of federal change due to the final allowance of a federal net operating loss carryback from a loss year ending prior to 12/31/86, the date of overpayment will be the close of the taxable year in which the deduction, losses, or other item or event occurred which created the federal carryback, or the date when the return for the carryback year is filed, whichever is later. IAC § 100.9400(c)(3)(B); or

2. In the case of a federal change due to the final allowance of a carryback or carryforward from a loss year ending on or after 12/31/86, and in the case of an Illinois change due to the carryforward or carryback of an Illinois net loss, Illinois investment credit, jobs credit, replacement tax credit, or other credit (other than estimated or tentative tax credit from a loss or credit year ending on or after December 31,1986), the date of overpayment shall be the date the claim for refund is filed. However, if any overpayment is refunded within 3 months of the date the claim for refund is filed, no interest will be allowed. IAC § 100.9400(c)(3)(C).

A signed IL-870 (Waiver of Restrictions) reflecting an overpayment will also be considered a claim for refund.

5. Interest on Penalties

FOR RETURNS DUE ON AND AFTER JANUARY 1, 2001, INTEREST IS NO LONGER COMPUTED ON PENALTIES, ONLY TAX. REF: UPIA SECTION 3-2(c-5).

THIS PARAGRAPH APPLIES TO PENALTIES, WHICH ARE ASSESSED ON LIABILITY PERIODS WITH ORIGINAL DUE DATES, WHICH OCCUR ON OR AFTER JANUARY 1, 1994 AND ON OR BEFORE DECEMBER 31, 2000.

Any time a UPIA penalty is assessed on a liability period, the penalty will accrue interest from the due date of the original return without regard to extensions. The interest will be assessed at the same rate as interest on tax. The interest will be assessed in the same manner as the penalty to which it applies.

Example: Corporation A is a calendar year, Illinois filer. Corporation A files its original return for 1993 on November 15, 1994. Corporation A's return reflects a tax liability of $100,000 which Corporation A paid with its return. When Corporation A's return is processed, Corporation A will be billed for a UPIA late-filing penalty of $5,000 plus interest on the penalty from March 15, 1994. Corporation A will also be billed for a UPIA estimated payment penalty of $13,500 plus interest on the penalty from March 15, 1994. Finally Corporation A will be billed for interest on the tax from March 15, 1994 until the date the tax was paid, November 15, 1994.

The interest due on the tax will not continue to accrue after November 15, 1994 since the tax liability was paid, however, interest on each of the penalties will

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continue to accrue until the date each of the PENALTIES are paid. The only way for A to protest either the penalties or the interest on tax or penalties is to pay the liability and file a claim since the penalties and the interest are being assessed on an admitted, deemed assessed liability.

If, in December of 1995, an audit is completed on Corporation A's 1993 return resulting in a $50,000 liability which the taxpayer disagrees to at the field level, a UPIA late-filing penalty of $2,500 will be proposed based on the additional liability established in audit. In addition, interest on the tax due and on the late-filing penalty will be computed starting with the original due date of the 1993 return, March 15, 1994. Corporation A will be able to protest the tax and the late-filing penalty related to the audit since the penalty is being assessed on a protestable tax liability.

As discussed under the heading Interest On Deficiencies, if the taxpayer pays the total amount due on a notice and demand within 30 days of the date of the notice and demand, no additional interest accrues from the date of the notice and demand. This provision applies to interest on penalties as well as interest on tax.

6. Interest On Erroneous Refunds

UPIA § 3-2(e) states:

> "Any portion of the tax imposed by an Act to which this Act is applicable or any interest or penalty which has been erroneously refunded and which is recoverable by the Department shall bear interest from the date of payment of the refund. However, no interest will be charged if the erroneous refund is for an amount less than $500 and is due to a mistake of the Department."

The erroneous refund provisions of IITA § 1003 were deleted with the enactment of UPIA.

If an erroneous refund is being recovered in audit it is important to remember that interest will be charged not only on the tax being recovered but also any penalties and interest being recovered.

Example: Corporation A incurs an Illinois net loss in calendar year 1993 which Corporation A carries back to 1990 to offset income in that year. Corporation A files an IL-1120X for 1990 claiming a refund of $50,000. The refund is issued to Corporation A on March 15, 1995 for a total amount of $54,210 ($50,000 plus $4,210 of interest).

In January 1997, an audit is conducted on 1993 and it is determined that Corporation A had no Illinois net loss to carry back to 1990. The refund, which was issued in March of 1995, is considered an erroneous refund, therefore, a deficiency

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is proposed of $54,210 plus interest on the entire amount from March 15, 1995 until the date of payment.

7. Restricted Interest

"Restricted interest" is a federal income tax term which refers to the interest that is due on underpayments that are reduced or extinguished by a carryback that is not effective as of the original due date. For example, a federal capital loss may extinguish a tax liability, but restricted interest will need to be computed on any tax underpayment until the effective date that the Illinois tax was reduced by the federal capital loss.

Restricted interest accrues from the date of underpayment until the date the carryback that reduces or eliminates the underpayment is deemed to occur. Federal capital loss and net operating loss carrybacks are deemed to arise on the original due date of the loss year return. IRC § 6601(d)(1). The same rule should apply for Illinois net loss carrybacks prior to the UPIA. After the interest provisions of the UPIA took effect on January 1, 1994, Illinois net loss carrybacks are deemed to arise on the last day of the loss year. UPIA § 3-2(d).

Underpayments that are eliminated by a carryforward do not accrue interest because the carryforward is in existence before the year of the underpayment, so that the tax eliminated by the carryforward is never actually underpaid. The one exception to this rule is when the carryforward is actually produced by a carryback from a loss year after the year of the underpayment, such as when the carryback of a federal capital loss causes the taxpayer to have an Illinois net loss in the carryback year. In that case, the Illinois net loss created by the carryback is not deemed to arise until the original return due date of the capital loss year, so that any underpayment for a year prior to the capital loss year will accrue restricted interest until the capital loss is deemed to arise.

8. Additional Audit Situations

As often happens, situations are encountered in audits that do not precisely fit within the basic definitions shown above. The following examples reflect some of those situations.

a) Taxpayer files a claim for refund carrying back an Illinois Net Loss prior to January 1, 1994

The date the claim is filed determines the "date of overpayment" only for the Illinois net loss reflected on the claim. Any audit adjustments, which increase the amount of loss or increase or decrease the amount of income in the carryback year(s), would not use this original "date of overpayment" for interest computation purposes. Instead, if the IL-870 is signed prior to January 1, 1994, the date the IL-870 is signed will determine the "date of overpayment" for any additional overpayment created in audit. If the IL-870 is signed after January 1, 1994, the "date of

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overpayment" for the additional overpayment created in audit would be the end of the loss year.

Had the Audit Bureau not discovered the error which increased the amount of Illinois net loss available to be carried or increased or decreased the amount of income in the carryback year(s), the taxpayer would have had to file a subsequent, amended return to correct the error. If this had happened, the additional overpayment would have had a "date of overpayment" which was determined based on the filing date of the subsequent claim (prior to January 1, 1994) or the end of the loss year (on or after January 1, 1994).

Example 1: Corporation A incurred an Illinois net loss in 1989 and filed a claim on 1/12/91 to carryback the Illinois net loss to 1986. In a 1992 audit, the 1989 Illinois net loss is increased and the increase is also carried back to 1986.

The date of overpayment for the original claim amount is 1/12/91. The date of overpayment for the additional amount carried back per audit is the date the IL-870 is signed.

Example 2: Given the following information for Corporation A:

1986: (Prior to any Illinois net loss being carried back)

IL Net Income	As filed	$2,000,000	
Tax	As filed		$ 130,000
IL Net Income	Per audit	$4,000,000	
Tax	Per audit		$ 260,000

1989:

IL Net Loss	As filed	(8,000,000)
IL Net Loss	Per audit	(8,100,000)

Corporation A filed a claim on 1/1/91 to carry back $2,000,000 of the 1989 IL Net Loss to 1986. The "date of overpayment" for the claim amount of $130,000 is 1/1/91. Interest would accrue on the overpayment from 1/1/91 until the refund is issued.

In 1992, an audit is conducted on the tax years 1986 through 1989. The Illinois audit adjustments increased the amount of Illinois income in 1986 and carried back an additional $2,000,000 of the 1989 Illinois net loss. Therefore, the IL-870 would net the "pre-loss" tax increase to 1986 and the additional 1989 loss carryback decrease to 1986 tax and would reflect no change in the tax liability for 1986. In addition, the IL-870 would reflect interest which had accrued on the additional "pre-loss" tax increase per audit of $130,000 from 3/15/87 (the original due date of the 1986 return without extensions) until 3/15/90, the unextended due date of the 1989 return. IRC§ 6601(d)(1).

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Example 3: Corporation A incurred an Illinois net loss in 1992 and filed a claim on 11/12/93 to carryback the Illinois net loss to 1989. In an audit that was completed in 1994, the 1992 Illinois net loss is increased and the increase is also carried back to 1989. The IL-870 is signed 12/20/94.

The date of overpayment for the original refund requested on the 1989 claim is 11/12/93, the date the claim is filed. The additional amount of refund that was carried back in audit has a date of overpayment of the end of the loss year (12/31/92).

b) Illinois net loss is carried forward on an ORIGINAL RETURN

This section deals with an audit adjustment that either:

- Increases the amount of loss available to be carried forward, or
- Increases the amount of credit which can be carried forward, or
- Increases or decreases the amount of income which can be offset by the loss, and

THE NET RESULT OF THE AUDIT IS NOT AN OVERPAYMENT.

The additional Illinois net loss or credit which is carried forward in audit will be considered to have been carried forward as of the date the original return for the carryforward year was filed.

In determining whether there is an underpayment of tax on the original return, we should determine the amount that was required to be shown as tax on the return based on the facts in existence as of the end of the taxable year. The amount required to be shown as tax on the original return is reduced by the amount of any deduction in computing net income and any credit against the tax, which was properly allowable on the date the return was required to be filed. There is no underpayment if there was a deduction or credit available (including an Illinois Net Loss which is available for carryforward to the tax year) on the date the original return was filed which could be used to reduce the taxpayer's liability.

Example 1: Corporation A incurs Illinois net losses in 1986, 1987, 1988 and 1989. The 1986 through 1988 Illinois net losses are carried forward on the original return filed for 1990 and totally offset the 1990 Illinois income. In audit, the 1990 Illinois income is increased by $500,000 and the 1989 Illinois net loss is carried forward and, again, totally offsets the income for 1990. On the IL-870 the tax effects of the increase in "pre-loss" income and the allowance of the additional carryforward of the 1989 Illinois net loss are netted and result in no additional tax liability per audit for 1990. No interest would be computed in this situation since the Illinois net loss was carried forward on the original return for 1990 AND THE AUDIT DID NOT RESULT IN A REFUND.

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Example 2: Given the following facts for Corporation A:

1987	Illinois net loss	As Filed	$1,000,000
1988	Illinois net loss	As Filed	500,000
1989	Illinois net loss	As Filed	800,000
		Per Audit	1,000,000

1990 (Prior to any Illinois net loss being carried forward):

Illinois net income	As Filed	$3,000,000	
Tax	As Filed		$ 219,000
Illinois net income	Per Audit	4,000,000	
Tax	Per Audit		292,000

(with Illinois loss c/f)

Illinois net income	As Filed	$ 700,000	
Tax	As Filed		$ 51,100

Corporation A filed a timely IL-1120 for 1990 carrying forward all of its 1987, 1988 and 1989 Illinois net losses. The IL-1120, as filed, reflected remaining 1990 Illinois income of $700,000, resulting in a tax liability of $51,100 which Corporation A had paid as of 3/15/91.

An audit was conducted on Corporation A for the period of 1987 through 1990. The amount of Illinois net loss originally reported in 1989 and the amount of income originally reported in 1990 were each increased (see above). The increased amount of loss in 1989 was carried forward and the "net" audit increase to income for 1990 was $800,000. This resulted in a "net" audit tax increase of $58,400.

Since the Illinois net losses were originally carried forward on the original return and THE AUDIT DID NOT RESULT IN AN OVERPAYMENT, interest on the "net" audit tax increase of $58,400 would be computed from the original due date of the return (3/15/91) through the date the liability is paid.

c) Taxpayer has carried forward an Illinois net loss or credit on an AMENDED RETURN

This section deals with an audit adjustment that either:

- Increases the amount of loss or credit available to be carried forward, or
- Increases or decreases the amount of income which can be offset by the loss or credit, and

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THE NET RESULT OF THE AUDIT WILL NOT BE A REFUND.

The additional Illinois net loss credit which is carried forward in audit will be considered to have been carried forward as of the date the amended return was filed.

Example 1: Corporation A incurs Illinois net losses in 1986, 1987, 1988 and 1989. No Illinois net losses are carried forward on the original return filed for 1990 and Corporation A pays the liability reflected on the return as filed. On 1/1/92 Corporation A files an amended return carrying forward the 1986 through 1988 Illinois net losses which totally offset the 1990 Illinois income. Interest on the resulting refund would begin to accrue on the date of overpayment (i.e. the date the claim was filed -1/1/92) and would continue to accrue until the date the refund is issued.

In audit, the 1990 Illinois income is increased and the 1989 Illinois net loss is carried forward to completely offset the audit increase to income for 1990. On the IL-870 the tax effects of the increase in "pre-loss" income and the allowance of the additional carryforward of the 1989 Illinois net loss are netted and result in no additional tax liability, per audit, for 1990. Although the taxpayer did not claim the net loss deduction until it filed an amended return over one year after the unextended due date of the return, so that interest did not accrue on the refund until the refund claim was filed, a net loss carryforward deduction sufficient to eliminate all net income after all audit adjustments was in existence as of the end of the tax year, so there is no underpayment on which interest may accrue.

Example 2: Given the following facts for Corporation A:

1987	Illinois Net Loss	As Filed	$1,000,000
1988	Illinois Net Loss	As Filed	500,000
1989	Illinois Net Loss	As Filed	800,000
		Per Audit	1,000,000

1990 (Prior to any Illinois net loss being carried forward):

Illinois Net Income	As Filed	$3,000,000	
Tax	As Filed		$219,000
Illinois Net Income	Per Audit	4,000,000	
Tax	Per Audit		292,000

Corporation A filed a timely IL-1120 for 1990 without carrying forward any Illinois net losses, reporting 1990 Illinois income of $3,000,000 and a tax liability of $219,000. The $219,000 had been paid as of 3/15/91. On 1/1/92 Corporation A filed an amended return carrying forward the 1987, 1988 and 1989 Illinois net losses and offsetting all but $700,000 of Illinois income in 1990. Interest on the

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overpayment would begin to accrue on the date of overpayment (i.e. the date the claim was filed - 1/1/92) and would continue to accrue until the date the refund was issued.

An audit was conducted on Corporation A for the period of 1987 through 1990. The amount of Illinois net loss originally reported in 1989 and the amount of income originally reported in 1990 were each increased (see above). The increased amount of loss in 1989 was carried forward and the "net" audit increase to income for 1990 was $800,000. This resulted in a "net" audit tax increase of $58,400.

Interest would accrue only on the "net audit tax increase", taking into account both the increase in 1990 income and the increase in Illinois net loss carryforward deduction, and the interest would accrue from the 1/1/92 date of underpayment through the date the liability is paid. Any interest paid on the original refund would also have to be repaid by the taxpayer, to the extent the original refund is reduced by the net audit tax increase.

d) Taxpayer has carried forward an Illinois net loss on either an original return or an amended return

This section deals with an audit adjustment that either:

- Increases the amount of loss available to be carried forward, or
- Increases or decreases the amount of income which can be offset by the loss, and

THE NET RESULT OF THE AUDIT WILL BE A REFUND.

The additional Illinois net loss which is carried forward in audit will be considered to have been carried forward as of the date the IL-870 is signed.

Example 1: Given the following facts for Corporation A:

1987	Illinois Net Loss	As Filed	$1,000,000
1988	Illinois Net Loss	As Filed	500,000
1989	Illinois Net Loss	As Filed	800,000
		Per Audit	1,500,000

1990 (Prior to any Illinois net loss being carried forward):

Illinois Net Income	As Filed	$3,000,000	
Tax	As Filed		$219,000

Corporation A filed a timely IL-1120 for 1990 carrying forward all of its 1987, 1988 and 1989 Illinois net losses. The IL-1120, as filed, reflected remaining

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1990 Illinois income of $700,000 resulting in a tax liability of $51,100 which Corporation A had paid as of 3/15/91.

An audit was conducted on Corporation A for the period of 1987 through 1990. The amount of Illinois net loss originally reported in 1989 was increased (see above). The increased amount of loss in 1989 was carried forward and completely offset the remaining 1990 Illinois income, resulting in an audit overpayment of $51,100. Interest on the audit overpayment would begin to accrue as of the date the IL-870 is signed.

Example 2: Given the following facts for Corporation A:

1987	Illinois Net Loss	As Filed	$1,000,000
1988	Illinois Net Loss	As Filed	500,000
1989	Illinois Net Loss	As Filed	800,000
	Tax	Per Audit	2,000,000

1990 (Prior to any Illinois net loss being carried forward):

Illinois Net Income	As Filed	$3,000,000	
Tax	As Filed		$219,000
Illinois Net Income	Per Audit	4,000,000	
Tax	Per Audit		292,000

Corporation A filed a timely IL-1120 for 1990 carrying forward all of its 1987, 1988 and 1989 Illinois net losses. The IL-1120, as filed, reflected remaining 1990 Illinois income of $700,000 resulting in a tax liability of $51,100 which Corporation A had paid as of 3/15/91.

An audit was conducted on Corporation A for the period of 1987 through 1990. The amount of Illinois Net Loss originally reported in 1989 and the amount of income originally reported in 1990 were increased (see above). It was agreed in audit to carry forward the increased amount of loss for 1989 and offset all but $500,000 of the revised 1990 Illinois income. This resulted in a "net" audit overpayment of $14,600.

No interest would accrue on the tax resulting from the "pre-loss" audit increase to 1990 income. Interest on the "net" audit overpayment of $14,600 would begin to accrue on the date the IL-870 was signed and continue to accrue until the date the refund was issued.

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Example 3: Given the following facts for Corporation A:

1987	Illinois Net Loss	As Filed	$1,000,000
1988	Illinois Net Loss	As Filed	500,000
1989	Illinois Net Loss	As Filed	800,000
		Per Audit	2,000,000

1990 (Prior to any Illinois net loss being carried forward):

Illinois Net Income	As Filed	$3,000,000	
Tax	As Filed		$219,000
Illinois Net Income	Per Audit	4,000,000	
Tax	Per Audit		292,000

Corporation A filed a timely IL-1120 for 1990 without carrying forward any of its Illinois net losses. The IL-1120, as filed, reflected 1990 Illinois income of $3,000,000 resulting in a tax liability of $219,000 which A had paid as of 3/15/91. On 1/1/92 Corporation A filed an amended return carrying forward all of its 1987 through 1989 Illinois net losses. The amended return reduced 1990 income to $700,000 and reflected an overpayment of $167,900. Interest on this overpayment would accrue from the date the claim was filed (1/1/92) until the date the refund was issued.

An audit was conducted on Corporation A for the period of 1987 through 1990. The amount of Illinois net loss originally reported in 1989 and the amount of income originally reported in 1990 were increased (see above). It was agreed in audit to carry forward the increased amount of loss for 1989 and offset all but $500,000 of the revised 1990 Illinois income. This resulted in a "pre-loss" audit tax increase of $73,000 and a "net" audit overpayment of $14,600.

No interest would accrue on the "pre-loss" audit tax increase of $73,000 because the increase is entirely offset by the net loss carryforward. Interest on the "net" audit overpayment of $14,600 would begin to accrue on the date the IL-870 was signed and continue to accrue until the date the refund was issued.

e) Original return for carryforward year filed reflecting an Illinois net loss - agreed audits.

The following discussion concentrates on agreed audit adjustments to years for which an original return was filed reflecting an Illinois net loss. The positions taken below would also apply if the same types of adjustments are made by a taxpayer through the filing of an amended return which creates income in a year and simultaneously offsets the increase by an Illinois net loss or excess credit carryforward.

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(1) Offsetting Between Different Taxpayers

In the situation where the taxpayer wants to offset between different taxpayers such as one factor and three factor combined returns, the Auditor should prepare an offset statement for the taxpayer's signature. This statement should detail the tax overpaid, the tax underpaid plus any applicable penalty and the balance due or overpayment after the offset. This signed statement will give Audit Perfection the authority to offset the overpayments and underpayments and either bill the taxpayer for the balance due or refund any remaining overpayment after the interest is computed. See Exhibit G.

(2) Overpayment Date When Refund Not Due to Carrying Losses/Credits

When an overpayment is the result of an audit where several separate filing companies are combined into one group, the date of overpayment is the due date of the overpaid return, the date the return was filed or the date the tax was paid, whichever is later.

Example: An audit was conducted on companies A, B, C, D and E for YE 12/93. The five companies filed separate original returns on the extended due date of 10/15/94. All of Company B's tax was paid as of 3/15/94. As a result of the audit and the subsequent legal settlement, the five companies were determined to be unitary and a combined return was prepared. The results are as follows:

	Company A	Company B	Company C	Company D	Company E	Combined
FTI	(10,000)	5,000	7,500	(20,000)	2,500	(15,000)
Mods	500	200	(7,500)	0	(2,500)	(9,300)
Bus Inc	(9,500)	5,200	0	(20,000)	0	(24,300)
Ill Bus Inc	(4,500)	2,600	0	(2,500)	0	(4,400)
Tax Paid	0	200	0	0	0	200

The taxpayer signed an IL-870 agreeing to the legal settlement. The overpayment date for the calculation of refund interest in this situation is the date the return was filed. IAC §9400(c)(3)(A)

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(3) Carrying Losses In Unagreed Audits

The correct amount of loss or credit will be properly carried forward or back in unagreed audits. This policy resulted from both the amendment of IITA § 905(e) and the need to reflect the correct loss and/or credit available to carry forward to future periods.

As a result, no interest will be due on an unagreed liability that is offset by loss carryforwards. If the audit results in no liability due because the adjustments were offset by a loss or credit carryforward, the Auditor should follow the "LR" procedure. The taxpayer will be able to protest if and when there is a tax effect in a future period. The Auditor is required to provide the taxpayer with details of all adjustments made along with EDA-143-LR, Notice of Audit Results, Net Loss and Credit Reductions, informing them of our findings and their rights to protest. Refer to Chapter 20 Income Tax Audit Procedure regarding the creation of the EDA-143-LR.

The only exception to the above situation is where the taxpayer has not filed and will not file loss year returns. If the Auditor cannot secure loss year returns from the taxpayer, there will be no loss available to carry. A notice of deficiency will be issued for the entire liability due including the applicable penalty and interest.

(4) Interest Issues On Loss Carryforwards

There is no restricted interest on a liability established in audit which is offset by the carryforward of a federal net operating loss, Illinois net loss or Article 2 credit even if the loss year return is filed late. The loss year return must be filed in order for the loss to be carried.

The following examples illustrate the interest calculations to be used when an Illinois net loss is being carried forward or back, an excess Illinois Article 2 credit is being carried forward or a federal capital loss is being carried forward or back.

The examples assume the following:

1. The taxpayers file calendar year returns.

2. The term “excess credits” refers to excess Article 2 credits. It does not refer to an overpayment on an original return that is credited to the next year’s estimated tax payments.

3. The terms “pre-loss” and “pre-credit” refer to the audit liability that exists if the loss or excess credit carryforward is not taken into consideration.

4. The term “original due date” refers to the due date of the return without regard to extensions.

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(5) Original Return – Carryforward Year – Illinois Net Loss

The following examples illustrate years in which the original return was filed reflecting an Illinois net loss and the audit adjustments created income. The income was then offset by an available loss or credit carryforward. These examples would also apply if the taxpayer made the same type of adjustment by filing an amended return.

(a) Complete Offsets

When a taxpayer filed an original Illinois return reflecting an Illinois net loss and, in audit, it is determined that the return should have reflected income, no restricted interest will be computed on the proposed audit liability if:

1. Illinois net losses or excess credits incurred in prior years can be carried into the year to completely offset the amount of income and/or tax proposed in audit, and

2. The taxpayer has filed Illinois returns for the loss or excess credit years.

The offset of a proposed audit liability with a loss or excess credit carryforward is not considered a refund, so the date of overpayment rules contained in IAC § 100.9400(c)(3)(C) do not apply. Since the Illinois net losses or excess credits are available to offset the income and/or tax in a carryforward year as of the original due date of the carryforward year's return there is no underpayment and, therefore no underpayment interest.

Example 1: Corporation ABC timely filed its Illinois returns for 1995, 1996 and 1997. All three returns reflected Illinois net losses.

In 1999, an Illinois audit determines that Corporation ABC incurred Illinois income for 1997. The Illinois net losses for 1995 and 1996 were available to be carried forward to completely offset the Illinois income proposed in audit. The auditor verifies that the losses are correct and carries them forward to offset all of the income for 1997.

No restricted interest will apply to the proposed pre-loss audit liability for 1997. The Illinois net losses were available to offset income as of the original due date of the carryforward year return. There is no underpayment, so there is no interest.

Example 2: Corporation BCD timely files its Illinois returns for 1995, 1996 and 1997. The returns for 1995 and 1996 reflect excess credits and the return for 1997 reflects an Illinois net loss.

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In 1999 an Illinois audit determines that Corporation BCD actually incurred Illinois income for 1997 which results in a tax liability for that year. The excess credits for 1995 and 1996 are verified and carried forward to completely offset the Illinois tax liability established in audit.

No restricted interest would apply to the pre-credit audit liability for 1997. The excess credits were available to offset tax as of the original due date of the carryforward year return. There is no underpayment, so there is no interest.

(i) Agreed Audits

When the proposed audit liability is being completely offset by Illinois net loss or excess credit carryforwards and the taxpayer agrees, the Auditor can prepare amended returns and secure the taxpayer's signature. However, if an IL-870 is obtained, it should be completed as follows:

1. The pre-loss or pre-credit audit tax liability should be entered as a positive number in the liability section;

2. The identical reduction to the audit liability due to the loss or excess credit carryforward should be entered as a decrease (brackets) in the liability section; and

3. No penalty or interest amounts will be entered on the IL-870.

(ii) Unagreed Audits

If the taxpayer disagrees with the audit liability and the amount of loss or excess credit carried forward or back, the Auditor will complete the following steps:

1. The correct amount of loss or credit available to carry will be calculated and applied;

2. If an Illinois net loss, it will be determined if the loss was properly carried back or a proper election was made to forgo the carry back period; and

3. If the carryforward offsets all of the audit liability and there is no tax effect, the Auditor will close the audit following the "LR" procedure.

UPIA § 3-3(b) penalty (if applicable) should be applied to any net audit liability remaining after the prior year(s) Illinois net losses and/or excess credit carryforwards have been applied.

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(b) Partial Offset In Agreed Audits

In the above situations, if the Illinois net losses or excess credits which are being carried forward do not completely offset the income and/or tax determined in audit for the carryforward year, interest will be computed on the portion of the audit liability not offset by the carryforward. In general, interest would accrue from the original due date of the return, however, if an overpayment existed on the original return, refer to Interest Computations.

(c) Partial Offset In Unagreed Audits

In an unagreed audit, if the carryforward does not offset all of the liability due, a notice of deficiency will be issued for the net tax due. The Auditor will follow the unagreed audit procedures.

Interest will be computed on the net tax due as in an agreed audit.

(6) Late Filers/Non-Filer

An Illinois net loss or excess credit cannot be carried forward by a taxpayer until an Illinois income tax return has been filed establishing the Illinois net loss or excess credit. REF: Sunshine letter IT95-0045.

If a taxpayer files an original return late which reflects an Illinois net loss or excess credit and then carries that loss or credit forward on a future year return, the loss or credit will be available as of the due date of the carry year return. No restricted interest will be due on the liability that was offset by the carryforward.

Example: Corporation CDE files its returns for 1995 and 1996 on January 1, 1998. Corporation CDE files its return for 1997 on October 15, 1998. All three returns reflect Illinois net losses.

In 1999, an audit determines that Corporation CDE actually incurred income in 1997. The Illinois net losses for 1995 and 1996 were verified and carried forward to completely offset the 1997 Illinois income established in audit.

No interest would apply to the proposed pre-loss audit liability for 1997. Although the original returns for 1995 and 1996 were filed late, there were still filed prior to the loss being carried. The Illinois net losses were available to be credited as of the original due date of the carryforward year return. There is no underpayment, so there is no interest.

The return(s) establishing a loss or excess credit must be filed prior to any carryforward application. However, the loss or excess credit is available as of

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the due date of the carryforward return, regardless of when the loss year or credit year return is filed.

Example: Corporation DEF files its returns for 1995, 1996 and 1997 on October 15, 1998. All three returns reflect Illinois net losses.

In 1999, an audit determines that Corporation DEF actually incurred income in 1997. The 1995 and 1996 Illinois net losses are verified and carried forward to completely offset the 1997 Illinois income determined in audit.

No interest will accrue on the pre-loss audit liability for 1997 since the returns reporting the Illinois net losses were filed.

If the taxpayer incurred Illinois net losses or excess credits and has not filed returns for those loss years, the losses have not been established and cannot be carried. If the auditor secures original, signed returns or the taxpayer voluntarily files the returns, the losses or credits will be available as of the due date of the carryforward year return.

However, if the taxpayer does not file the loss year returns, the loss will not be carried in audit because the loss has not been established. A notice of deficiency will be issued for the entire audit adjustment.

(7) Losses Carried Back January 1, 1994 and After

If an amended return is filed or a signed IL-870 is received on or after January 1, 1994 carrying back an Illinois Net Loss, the date of overpayment is the end of the loss year even if the loss year return is filed late. The claim for refund must be filed within three years of the due date of the loss year return including extensions or within the period of a waiver of the statute of limitations plus six months. If the loss year return is filed within that period even though late, the date of overpayment is the end of the loss year. REF: IAC § 100.9400(c)(3)(D).

Example: Corporation KLM timely files its 1993, 1994 and 1995 returns reporting income and paying the tax due. Amended returns were filed on 3/15/99 carrying back the 1996 Illinois net loss to 1993 and 1994. However, when reviewing the amended returns, it is discovered that the 1996 return has not been filed. When contacted, the taxpayer filed the original 1996 return on 7/1/99. The overpayment date is 12/31/96, the end of the loss year.

Corporation LMN has not filed returns for 1996 and 1997. In an audit of the period, it is determined that the 1996 return has income and the 1997 return has an Illinois net loss. The liability is established for 1996 and the original return is obtained for 1997. The 1997 Illinois net loss is carried back to offset the 1996 income.

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Restricted interest will be computed on the 1996 liability from the due date of the return to the end of the loss year which is 12/31/97.

(8) Capital Loss Carryback and Forward – Date of Overpayment

Whenever a capital loss is carried back or forward, the date of overpayment is either the claim received date or the date the IL-870 is signed per IAC § 100.9400(c)(3)(C). The capital loss is carried back before the federal net operating loss, Illinois net loss and Article 2 credit carryforwards are applied as of the claim received date. In most cases, a capital loss carryforward will be applied as of the due date of the carry year return.

Example: Company JKL has an Illinois net loss in 1995 and incurs a capital loss that cannot be absorbed by capital gains in 1997. The Illinois net loss cannot be used in years prior to 1995 and there are not capital gains in 1994 and 1995 that can offset the capital loss. The 1997 capital loss would be applied to the 1996 capital gain as of the claim received date. The 1995 Illinois net loss would be carried forward as of the due date of the 1996 return.

	1995	**1996**	**1997**
FTI(Loss)	(500,000)	200,000	180,000
Cap Gain/(Loss)	0	25,000	(10,000)
Carry 1997 Cap Loss		(10,000)	10,000
FTI/(Loss)	(500,000)	215,000	180,000
Appt Factor	.50	.75	.75
Ill Net Inc/(Loss)	(250,000)	161,250	135,000
C/F 1995 INL	250,000	(161,250)	(88,750)
Illinois Income After Loss	0	0	46,250

(9) Audits with RAR and Illinois Adjustment To Losses

Example: Corporation FGH timely filed its Illinois returns for 1995, 1996 and 1997. The taxpayer elected to carry forward the Illinois net losses from 1990 and 1991 to 1995 and 1996 and offset all of the Illinois income. The return for 1997 reflected an Illinois net loss. Illinois net losses from timely filed returns for 1992, 1993 and 1994 were not carried forward because the Illinois net losses from 1990 and 1991 completely offset all of the income.

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In 1999 an Illinois audit determined that:

1. An RAR was completed for 1990 and 1991 and completely eliminated any Federal loss and resulted in Illinois net income for those years, and

2. 1997 was an income year resulting in a tax liability.

The Illinois tax liability was established for 1990 and 1991. Since no election was made to forgo the carryback period, the Illinois net losses for 1992 and 1993 were carried back to offset all income. The remaining 1993 loss was carried forward along with the 1994 loss to offset part of the 1995 income.

	AS FILED	PER AUDIT
1990	(50,000)	75,000
1991	(100,000)	25,000
1992	(70,000)	(70,000)
1993	(45,000)	(45,000)
1994	(20,000)	(20,000)
1995	60,000	60,000
1996	50,000	50,000
1997	(35,000)	65,000

Loss Application Schedule Per Audit								
	1990	1991	1992	1993	1994	1995	1996	1997
Income	75,000	25,000	-70,000	-45,000	-20,000	60,000	50,000	65,000
Carry Loss								
92 to 90	-70,000		70,000					
93 to 90	-5,000			5,000				
93 to 91		-25,000		25,000				
93 to 95				15,000		-15,000		
94 to 95					20,000	-20,000		
Remaining Income or Loss	0	0	0	0	0	25,000	50,000	65,000

The interest would be computed on the years with tax liability established as follows:

1. 1990 – Restricted interest would be computed from the due date of the 1990 return until the end of the 1992 and 1993 loss year;

2. 1991 – Restricted interest would be computed from the due date of 1991 return until end of the 1993 loss year;

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3. 1995 – No interest would be due on the liability to the extent it was offset by the $35,000 in loss carryforwards.

Also, pre-UPIA IITA § 1005 penalty would apply to 1990 and 1991.

The IL-870 should be completed as follows:

1. The pre-loss or pre-credit audit tax liability should be entered as a positive number in the liability section.

2. The reduction to the audit liability due to the loss or excess credit carryforward or carryback should be entered as a decrease (brackets) in the liability section.

3. The penalty or interest amounts will be entered on the IL-870.

If the audit is unagreed, the loss will be carried and the notice of deficiency will be issued for the penalty and restricted interest for 1990 and 1991 and the liability due for 1995, 1996 and 1997.

(10) Audits with Original Loss or Income Year Returns Not Filed

Example 1: Corporation GHI files its first return on October 15, 1996 for 1995. This return has an Illinois net loss of $50,000. No returns were filed for the subsequent years.

In 1999, in audit, it is discovered that Corporation GHI was required to file Illinois returns for 1996 and 1997. The audit determines that 1996 has an Illinois net loss of $25,000 and income for 1997 of $80,000.

On July 1, 1999, Corporation GHI files the original return for 1996, requests that the Illinois net losses for 1995 and 1996 be carried forward since there is no carryback period available, and agrees to the audit adjustment for 1997 by signing an IL-870. The Illinois net losses from 1995 and 1996 offset all but $5,000 of the 1997 income.

Since the loss year returns were filed, even though late, the loss was available as of the due date of the carry year return. No interest is due on the liability offset by the loss or credit carryforward. Interest and penalties will be computed on the tax liability due on the remaining income for 1997 that is not offset by the loss carryforward.

If the audit was unagreed and the taxpayer did not file the 1996 return, no loss would be carried.

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Example 2: Corporation HIJ started conducting business in Illinois in 1995 and does not file returns for 1995, 1996 and 1997. When contacted by Audit Bureau personnel in 1999, it is determined that the taxpayer has losses and Article 2 credits for 1995 and 1996 which offset all the income and tax due for 1997 as follows:

YEAR	1995	1996	1997
Income/Loss	-100,000	-250,000	500,000
Carry Loss 95 to 97	100,000		-100,000
96 to 97		250,000	-250,000
Remaining Income			150,000
Pre Credit Tax Due			10,950
Article 2 Credits Available	4,000	4,500	7,500

For the three-year period, the taxpayer has $16,000 in Article 2 credits available. The credit for 1995 and 1996 are carried forward to 1997 offsetting $8,500 of the tax due. The remaining 1997 tax due of $2,450 is offset by the credit earned in 1997. The remaining 1997 credit of $5,050 is available to carry to 1998.

If the taxpayer files the original loss year returns, the loss and credits will be carried forward and no penalty or interest will be due for 1997.

If the taxpayer disagrees and will not file the loss year returns, a notice of deficiency will be issued for the liability due for 1997 without the loss and credit offsets. Interest and late-filing penalty will be assessed.

(11) Original Returns Filed Reflecting Income-Audit Creates an Illinois Net Loss or Excess Credits-Agreed Audits

When a taxpayer has filed returns which reflect income and it is later determined that the taxpayer actually incurred an Illinois net loss or excess credits for one or more of the years, the Illinois net loss or excess credits will be considered to be realized or available for credit, as of the date the IL-870 is signed or an amended return is filed. This will not affect the calculation of interest on the overpayment which results in the loss or excess credit year (i.e., interest will accrue from the original due date of the return, the date the return was filed or the date the payment was received which created the overpayment). Also, if the loss or excess credits are carried forward to reduce income in a subsequent year, the income in the carryforward year will be considered to be offset as of the date the IL-870 is signed or the amended return reflecting the loss or excess credit is filed for purposes of computing the interest on any refund. However, no interest will

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accrue on any unpaid tax for the carryforward year to the extent the underpayment is reduced by the carryforward because the net loss or excess credit was in existence prior to the carryforward year, even if not reported until afterwards.

Example: Corporation J files its returns for 1989, 1990 and 1991 on October 15, 1990, October 15, 1991, and October 15, 1992 respectively. All of these returns reported Illinois income. For 1989, 1990, and 1991 Corporation J timely paid the tax liabilities of $1,000, $2,000 and $3,000 respectively. Corporation J received no credits or refunds from the original returns.

In 1994, due to an audit, it is determined that Corporation J actually incurred a loss for 1990 which would result in a refund of the $2,000 of tax paid and has additional income in 1991 which would result in a correct tax liability of $7,000. The 1990 loss determined in audit is available to be carried back or forward to offset income and Corporation J makes an election to carry it forward to completely offset the proposed audit liability of $4,000 in 1991.

On July 1, 1994, Corporation J agrees to the audit adjustments for 1990 and 1991 by signing an IL-870. For 1990, Corporation J will receive a refund of $2,000 and will receive interest on the $2,000 from October 15, 1991. For 1991, no interest will accrue on the audit liability of $4,000 because it is offset by a carryforward. If the carryforward also generates a refund for 1991, interest on the refund will run from July 1, 1994, the date of the refund claim.

The IL-870 would show a decrease (brackets) in tax of $2,000 for 1990. For 1991 the pre-loss audit liability of $4,000 should be entered as a positive number in the liability section and a $4,000 reduction to the audit liability due to the carryforward of the net loss should be entered as a decrease (brackets) in the liability section.

MOST SITUATIONS WILL FIT INTO ONE OF THE GENERAL CATEGORIES ABOVE. IF A UNIQUE SITUATION IS ENCOUNTERED, PLEASE CONTACT INCOME TAX TECHNICAL SUPPORT FOR ADVICE.

(12) Offsets Between Years

Offsets are only allowed between periods on the same IL-870, unless the Director approves otherwise. Interest should be computed on each period separately in the normal course before amounts are offset. Generally, the offset date for an audit period is the IL-870 issuance date. This means that refund interest should be calculated on overpaid periods through the IL-870 issuance date, and liability interest should be calculated on underpaid periods through the IL-870 issuance date. The auditor should then offset the total overpayment from overpaid periods against the total underpayment from underpaid periods, and the

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net overpayment/underpayment will continue to accrue overpayment/underpayment interest through the date of payment

Interest must be paid on any payment of tax liability that is later than the due date of the return. If at a later date this tax liability is reduced, the taxpayer has an overpayment of tax PLUS interest upon which interest is calculated.

If an audit situation arises where the taxpayer has an overpayment/underpayment the first year and an underpayment/overpayment the subsequent year, interest should be computed on each period separately before the amounts are offset.

Example 1: On June 30, 2011 (the IL-870 date), an audit is completed for tax years ending 12/31/06 and 12/31/07. Taxpayer made timely ES and IL-505-B extension payments totaling $15,000 for 2006 and filed its IL-1120 on 9/15/07 reflecting a $15,000 liability. Taxpayer also made timely ES and IL-505-B extension payments totaling $12,000 for 2007 and filed its IL-1120 on 5/15/2008 reflecting a $12,000 liability. The audit adjustment for 2006 reflects an RAR decreasing the liability to $11,000. The 2007 audit adjustment increased the tax liability by $4,500. Each year should be examined separately and then the results offset for determining the total audit refund or liability.

For 2006, interest will be paid on the $4,000 overpayment resulting from the audit (based on the RAR adjustment of taxable income) from the date of overpayment (09/15/2007) through the IL-870 issuance date (6/30/2011). The total interest is $613.27. Therefore, the total overpayment for 2006 is $4,613.27.

For 2007, penalty and interest must be calculated on the additional audit liability of $4,500 from the original due date of the return to the IL-870 issuance date (3/15/08 to 6/30/11). The late-payment penalty is $900.00 and interest is $1,040.05 (doubled for Amnesty). The total balance due for 2007 is $6,440.05.

The overpayment amount for 2006 of $4,613.27 can be used to offset the underpayment amount for 2007 of $6,440.05 creating a net underpayment amount of $1,826.78. Interest will continue to accrue on the underpayment until the date of payment.

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(13) Bankruptcy Computation of Interest

Interest will be calculated for audits where the taxpayer is involved in bankruptcy as follows:

The first calculation will compute interest on the total tax and penalty through the debtor's bankruptcy filing date. This amount is informational for the Bankruptcy Unit because they can only file a claim against the debtor with interest computed through the bankruptcy filing date. For claim purposes, interest stops accruing as of the bankruptcy filing date.

The second calculation will compute interest on the total tax and penalty through the date the audit is closed. This is the amount that will be assessed if the debtor's liability is not discharged through the courts. The Department will then be able to start collection activity against the debtor and/or responsible officer(s) for the entire amount of tax, penalty and interest.

In all instances, interest will continue to accrue on the tax and penalty (for applicable periods) that has not been discharged through the courts until the amount is paid.

(14) Bankruptcy Claims Bar Date

The time frame for the Department to file a claim against a Chapter 7 or 13 bankrupt account has changed. Generally, the bar date for Chapter 7 or 13 accounts is set for 90 days after a first meeting of creditors. This has been changed to 180 days from the bankruptcy filing date for both**.** (This time frame can be changed, but only by a Court Order).

In Chapter 11 bankruptcies, the setting of the bar date remains indefinite.

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V. EXHIBITS

A. Penalty and Interest Relief

1. Governor waives penalties, interest for taxpayers affected by severe weather, flooding

Gov. JB Pritzker announced today (May 13, 2019) that individuals and businesses devastated by severe weather and flooding that began on April 23, 2019, may request waivers of penalties and interest on state taxes if they cannot file their returns or make payments on time. Those impacted in the 36 counties declared a disaster are eligible to request a waiver of penalties and interest for income taxes, withholding taxes, sales taxes, and specialty and excise taxes.

"Communities across Illinois continue to be threatened by heavy rains and flooding and the state is committed to doing everything we can to help" said Governor JB Pritzker. "From providing sandbags and other resources to communities to waving penalties for impacted taxpayers who need more time to file, we want Illinoisans to know the state is on their side. During this time, I urge impacted individuals and businesses to take precautions, help their neighbors, and safely evacuate if necessary."

The counties covered by the disaster declaration include: Adams, Alexander, Brown, Bureau, Calhoun, Carroll, Cass, Fulton, Greene, Grundy, Hancock, Henderson, Henry, Jackson, Jersey, Jo Daviess, Knox, LaSalle, Madison, Marshall, Mason, Mercer, Monroe, Morgan, Peoria, Pike, Putnam, Randolph, Rock Island, Schuyler, Scott, St. Clair, Tazewell, Union, Whiteside, Woodford.

2. Governor waives penalties, interest for taxpayers affected by tornadoes, severe weather

Gov. Bruce Rauner announced today (December 6, 2018) that individuals and businesses devastated by tornadoes and severe weather in parts of Christian County on Dec. 1, 2018, may request waivers of penalties and interest on state taxes if they cannot file their returns or make payments on time. The waivers apply to individual and business income taxes, withholding taxes, sales taxes, and specialty and excise taxes.

"Families and businesses affected by the storms may need additional time to gather essential paperwork to file and pay their taxes," Rauner said. "The waivers help give taxpayers the time they need to recover and get their affairs in order. This is another way we can help them deal with the destruction caused by the storms."

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3. Taxpayers Affected by Hurricane Harvey and Hurricane Irma

The Illinois Department of Revenue will waive penalties and interest for taxpayers who cannot file or pay on time as a result of Hurricane Harvey (August 2017), Hurricane Irma (September 2017), and Hurricane Maria (September 2017).

4. July 2017 Flood Affected Taxpayers

Governor Bruce Rauner has declared Carroll, Cook, Henry, Jo Daviess, Kane, Lake, Lee, McHenry, Ogle, Rock Island, Stephenson, and Whiteside counties state disaster areas as a result of the flooding which occurred in July, 2017.

This waiver applies to affected taxpayers for payments or returns due between July 11, 2017 and December 31, 2017. This includes annual, monthly and quarterly returns and payments that would have been due during that time period, as well as estimated, semi-weekly, and accelerated payments. Taxes affected include individual income tax, business income tax, withholding taxes, sales and use taxes, motor fuel and excise taxes, bingo tax, pull tabs tax, and charitable games tax.

IFTA filers impacted by the storms can delay filing and paying their taxes for the second quarter of 2017 (April – June 2017, due July 3, 2017) and third quarter of 2017 (July – September 2017, due October 31, 2017), until December 31, 2017.

Other bill payments due during these months will be handled on a case-by-case basis with reasonable cause.

5. Taxpayers Affected by Hurricane Matthew

The Illinois Department of Revenue will waive penalties and interest for taxpayers who cannot file or pay on time as a result of Hurricane Matthew which occurred in October, 2016.

6. Disaster Relief 2015

Governor Bruce Rauner declared Alexander, Calhoun, Cass, Christian, Clinton, Cumberland, Douglas, Iroquois, Jackson, Jersey, Lawrence, Madison, Marion, Menard, Monroe, Morgan, Moultrie, Pike, Randolph, Richland, Sangamon, St. Clair, and Vermilion counties state disaster areas as a result of the flooding which occurred in December 2015 and January 2016.

The Department of Revenue will waive penalties and interest for taxpayers who cannot file or pay on time as a result of the flooding.

This waiver applies to affected taxpayers for payments or returns due between December 23, 2015 and June 30, 2016. This includes annual, monthly, and quarterly returns and payments that would have been due during that time period, as well as

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estimated and accelerated payments. Taxes affected include individual income tax, business income tax, withholding taxes, sales and use taxes, motor fuel and excise taxes, bingo tax, pull tabs tax, and charitable games tax.

IFTA filers impacted by the storms can delay filing and paying their taxes for the fourth quarter of 2015 (October – December 2015, due February 1, 2016) and the first quarter of 2016 (January – March 2016, due May 2, 2016).

Other bill payments due during these months will be handled on a case-by-case basis with reasonable cause.

7. [redacted]

8. [redacted]

9. Flood – April 2013

Illinois businesses and individuals who file monthly, quarterly or annual returns and have been impacted by the flooding will have until October 31, 2013 to file tax returns that were due on or after April 19. No late fees or penalties will be assessed.

Taxpayers who opt to mail their deferred returns and payment should write Flood-April 2013 on the outside of the envelope in red ink and on the top of each page of the tax filing, so the account can be updated and handled appropriately. Filers using My Tax Illinois or WebFile will be provided instructions when they file their returns.

For questions, the Illinois Department of Revenue has set up a mailbox dedicated to the flood issue: REV.FloodApr2013@illinois.gov.

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10. Super Storm Sandy 2012

The Department will waive penalties and interest for taxpayers who cannot file or pay on time as a result of Super Storm Sandy for 2012 tax year.

Taxpayers should file or pay as soon as possible. When they do, they should write "Super Storm Sandy 2012" in red on the outside of their envelope and on the top of the tax return. They should also include a brief written explanation of why they could not file timely.

Electronic filers, who do not mail tax documents, should notify the department by email at REV.SuperStormSandy@illinois.gov. The email should include the taxpayer's name, account identification number, period that is affected, and a brief explanation of why they will be late, along with an estimate of when they believe they can file or pay.

11. September 11, 2001 Terrorist Attack Penalty and Interest Relief

On September 20, 2001, Glen Bower, Director of Revenue, announced procedures that were to be used to allow taxpayers additional time to file and pay state taxes, in the wake of terrorist attacks on the World Trade Center and the Pentagon.

For income taxes (which parallel federal taxes), Illinois will conform to IRS guidelines with respect to income tax filing and payment requirements. The Illinois extensions will be identical to the federal extensions.

For Illinois specific taxes such as sales and use, utility, telecommunication, and other excise taxes, the Department will provide appropriate penalty and interest relief for returns and payments affected by the September 11, 2001 tragedies.

[redacted]

12. [redacted]

[redacted]

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[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

13. [redacted]

[redacted]

[redacted]

[redacted]

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B. Offset Statement

Overpaid Taxpayer Name:	ABC Transport, Inc. and Subs	
FEIN:	12-3456789	
Year:	XX/XX	XX/XX
Amount of tax overpaid:	-XXX.XXX	-XXX,XXX
Underpaid Taxpayer Name	ABC Manufacturing Inc. and Subs	
FEIN:	98-7654321	
Year:	XX/XX	XX/XX
Amount of tax Underpaid:	XXX,XXX	XXX,XXX
Net (Overpayment) or Underpayment	-X,XXX	X,XXX

I, the Designated Agent, authorize the offset of ABC Transport, Inc and subs overpayment by the ABC Manufacturing Inc and Subs underpayment. I agree that remaining overpayment should be refunded or any remaining underpayment should be billed.

Signature of Designated Agent of Overpaid Taxpayer_____

Signature of Designate Agent of Underpaid Taxpayer_____

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C. "10% Rule" for Abatement of Late-payment Penalty

IAC § 100.5020(d)(1), having no basis in law, has been removed from the regulations. The regulation contained the "10% rule" for abatement of late-payment penalties. The purpose of the rule was to avoid penalizing taxpayers that could not, for some reason, file returns by the due date and must estimate their true tax liability. It was basically an automatic reasonable cause exception to be used in processing for a temporary underpayment of tax which the taxpayer corrects with the filing of a return if full payment of the tax is made within the extension period. It was not a 10% tolerance for assessment of the penalty and was not to be used in audit situations.

IAC § 100.5020(d)(1) stated:

> …no penalty will be assessed if the amount of the underpayment is 10% or less of the amount of tax required to be shown on the return and the taxpayer pays such amount due by the extended due date.

This "10% rule" had no effect on audit liabilities, except that if an additional liability was found due in audit and the taxpayer originally avoided the late-payment penalty through use of this rule, the abatement was forfeited and a late-payment penalty was due on the original amount of tax shown due on the return and not paid by the date prescribed.

Although the regulation has been removed, GenTax is still applying the "10% rule". However, this should have no effect when audit proposes a deficiency on current audits. A late-payment penalty should be applied to the entire late-payment unless the taxpayer has reasonable cause.

This late-payment penalty is deemed assessed upon the filing of the return. EXECUTION OF AN IL-872 WILL NOT EXTEND THE STATUTE OF LIMITATIONS FOR ISSUING A NOTICE AND DEMAND FOR THIS PENALTY. Therefore, it is necessary to clearly indicate the statute expiration date for collecting the deemed assessed late-payment penalty in the Auditor's Comments.

> Example 1: Corporation A, a calendar year filer, makes $90,000 in timely estimated payments for 1993. On October 17, 1994 Corporation A files its IL-1120 for 1993 reporting a tax liability of $100,000. Corporation A pays the additional $10,000 with the Il-1120. Since Corporation A has paid 90% of the tax due by the date prescribed for payment and the remaining amount due by the extended due date, IAC § 100.5020(d)(1) will apply and no (b)(1) penalty will be assessed.
>
> In 1995, Corporation A's 1993 return is audited and the correct tax due for 1993 is determined to be $150,000 resulting in an audit deficiency of $50,000. Corporation A agrees to the audit changes. Corporation A has now forfeited the benefits of the 10% rule. A (b)(1) penalty now applies to the original $10,000 which was not paid by the due date of the original return (without extensions). This (b)(1) penalty will be

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assessed through issuance of an income tax notice and demand, which must be issued by October 17, 1997.

Example 2: Corporation B, a calendar year filer, makes $98,000 in timely estimated payments for 1993. On October 17, 1994, Corporation B files its IL-1120 for 1993 reporting a tax liability of $100,000. Corporation B pays the additional $2,000 with the IL-1120. Since Corporation B has paid 90% of the tax due by the date prescribed for payment and the remaining amount due by the extended due date, IAC § 100.5020(d)(1) will apply and no (b)(1) penalty will be assessed.

In 1995, Corporation B's 1993 return is audited and the correct tax due for 1993 is determined to be $105,000 resulting in an audit deficiency of $5,000. Corporation B agrees to the audit changes. Corporation B has now forfeited the benefits of the 10% rule even though Corporation B had paid 90% of the correct liability by the original due date of the return because the remaining amount due (the $2,000 per the return AND the $5,000 audit liability) was NOT paid by the extended due date. A (b)(1) penalty now applies to the original $2,000 which was not paid by the due date of the original return (without extensions). This (b)(1) penalty will be assessed through issuance of an income tax notice and demand, which must be issued by October 17, 1997.

Example 3: A calendar year taxpayer makes timely estimated payments totaling $1,000 for the 1990 tax year. On October 15, 1991, the 1990 IL-1120 is filed reporting a tax liability of $1,100. The taxpayer paid the additional $100 plus interest with the return. Due to the 10% rule a IITA § 1005 penalty is not computed on the $100 which was not paid by the due date of the return without extensions but WAS paid by the extended due date.

The taxpayer is subsequently audited for 1990 and the correct tax liability for 1990 is determined to be $10,000. The IITA § 1005 penalty would be computed on $9,000 from March 16, 1991 through October 15, 1991 and on $8,900 from October 16, 1991 through the date of payment.

Even though a "10% rule abatement" is forfeited because of a subsequent audit liability, that portion of the IITA § 1005 penalty, which is assessed on the tax reported on the original return, is deemed assessed on the FILING OF THE RETURN. Execution of an IL-872 will not extend the statute of limitations on the deemed assessed penalty.

In the above example, the deemed assessed penalty on the $100 of tax, which was shown on the original return, would have a statute expiration date of October 15, 1994.

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D. Interest on Deficiency- Revocation of Letter Ruling IT 93-0033

The IT 93-0033 letter ruling advised the taxpayer that penalties and interest computed on original carry year returns would stop accruing on the due date of the loss year's return rather than on the date the return was actually filed or the date the carryback is claimed.

In the taxpayer's situation original returns for the years ended 9/30/88, 9/30/89, 9/30/90 and 12/31/90 were all filed on 12/23/91. The 9/88, 9/89 and 9/90 returns showed tax deficiencies and Section 1001 Late Filing Penalty, Section 1005 Underpayment of Tax Penalty and Section 804 Underpayment of Estimated Tax Penalty were assessed. The 12/31/90 short period return showed an Illinois Net Operating Loss and the taxpayer requested the loss be carried back to 9/88, 9/89 and 9/90.

The taxpayer had received a billing from the Department for penalties and interest, which had been computed through 12/31/91. The taxpayer then relied upon federal rules to argue that penalties and interest computed through the due date of the 12/31/90 loss year return – 3/15/91 and not the 12/31/91 actual filing date.

An Illinois Net Operating Loss is established only after a return for the loss year is filed. In addition, the net loss carryback is not considered to be an overpayment until the carryback is claimed.

Under Section 100.9400(c)(3)(A). Date of Overpayment – There can be no overpayment of tax prior to the last date prescribed for filing the return, nor until the entire tax liability for the taxable year is satisfied, nor until the return is filed for the taxable year.

The issuance of Letter Ruling IT 96-0027 notifies the taxpayer that Letter Ruling IT 93-0033 was in error and explains the correct computation of penalties and interest in this net loss carryback situation.

This revoked letter ruling has no effect as audits have been computing interest correctly with respect to net loss carrybacks. This is for informational purposes only. Should a taxpayer rely on Letter Ruling IT 93-0033 for the computation of penalties and interest you will be able to instruct them it was issued in error.

Note that while this response is correct for this situation, effective January 1, 1994 the date of overpayment when an Illinois Net Loss carryback is involved is the last day of the loss year per Section 3-2(d).

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E. Federal Changes – Assessment of Late-file and Late-payment Penalty

	RAR			
	Late Filer		Timely Filed/Paid	
	Late-file Penalty	Late-payment Penalty	Late-file Penalty	Late-payment Penalty
Original Return				
Late Filer	✓	✓	✓	—
Timely Filed	—	✓	—	—

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GenTax Penalty and Interest Calculator

Issued 10/2014

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I. GENTAX P & I CALCULATOR

With the implementation of V9, please make sure that after entering new data into the P&I Calculator screens that the screens refresh. Screens should refresh by simply clicking out of the data entry fields and into any space outside of the screen. If this is not done, the penalties, interest and any automated fields may be incorrect.

Auditors are required to compute and include interest on the IL-870 for their taxpayers. This is done in GenTax using the Penalty and Interest Rate Calculator, which is identified on the system as “P&I Calculator”. This tool can be used to compute penalty and interest on an unpaid liability through a specific date, or to calculate interest on overpayments. For purposes of this section, the italicized words are fields or terms that are associated with the GenTax P&I Calculator (e.g. *Original Due Date* and *Interest Thru*).

Auditors must apply a thorough understanding of penalty, interest, and the appropriate statutes when using the calculator to arrive at the correct penalty and interest amounts.

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A. Using The P&I Calculator

Below is a screen shot of the GenTax V9 P&I Calculator

Note that the calculator is divided into four sections:

Period Info
Penalty
Interest
Amnesty

The P&I Calculator will calculate penalty/interest on liabilities and interest on overpayments. However, two different approaches must be used since the calculator is always going to treat the principal amount entered as a "balance due". One approach, enter all applicable payments, credits, refunds, and the corrected tax (i.e. the final adjusted tax in Column C of EDA-25, 24, etc.) for underpayments. The approach for overpayments will require entering only the overpayment amount(s) (i.e. the tax decrease

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from Column B of EDA-25, 24, etc.) in the calculator and computing the appropriate refund interest.

1. Audit Liabilities

For periods with an audit liability, the P&I Calculator is capable of calculating the same amount of penalty and interest that the Account springboard would for the taxpayer's account. The calculator is a stand-alone tool, however. This means that the auditor will have to input all payments, certain credits, refunds, and the tax required to be shown (corrected total tax including amended returns and audit) into the calculator for it to determine the correct amount of penalties and interest. Essentially, the auditor is "recreating" the entire tax and payment activity for the taxpayer.

It is important for the auditor to use the appropriate dates so that the correct interest and penalty are assessed.

For an audit liability:

- *Original Due Date* is the balance due date for the liability.
- *Interest Thru* date should be the issuance date of the IL-870.

For example, if an audit liability is established for a calendar 2005 IL-1120 that was originally timely paid (without any overpayment or subsequent payments), the *Original Due Date* would be 3/15/06. Liability interest begins to accrue the day after the payment entered in the *Original Due Date* field, or on 3/16/06 for a calendar 2005 IL-1120 due on 3/15/06. The *Interest Thru* date would be the IL-870 issuance date. If the taxpayer pays within 30 days of the IL-870 issuance date, then the UPIA late-payment penalty will remain at 15% and doubled for Amnesty and double interest will accrue until the tax is paid. If the taxpayer pays after the 30 days, then the penalty for UPIA-5 will increase to 20% and be doubled for Amnesty, and double interest will accrue until payment is made.

Remember, the interest you calculate for purposes of the IL-870 should be accrued through the IL-870 date. However, an IL-870 is not considered a notice and demand, so you should explain to the taxpayer that interest will accrue until payment is made, and provide the taxpayer projected interest amounts for a particular date if requested.

> Note: For simplicity's sake, all examples assume due dates that fall on the 15th of each month and dates of filing or payment ignore the possibility that the date is a Saturday, Sunday or holiday. If a due date for filing or payment falls on a Saturday, Sunday or holiday, filing or paying on the next business day is deemed to be timely, but the due date itself does not change. So if March 15 is a Saturday, a payment made on Monday, March 17 is timely, but a payment made on Tuesday, March 18 is 3 days late. IAC §100.5000(b).

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Example A: Company A made 4 timely calendar 2008 ES payments of $2,250 each and a timely extension payment (IL-505-B) of $1,000, as well as filing its 2008 IL-1120 on the 10/15/09 extended due date reporting a tax of $10,000. An audit is eventually performed finding an audit liability of $5,000. In determining the interest and penalty due, the auditor should enter all 5 payments made and enter $15,000 as the *Amount Due.* The $15,000 represents the "tax required to be shown", or the correct net income tax after the audit is performed.

2. Audit Claims

Note: All amounts must be entered as positive amounts in the P&I Calculator.

As previously stated, calculating the necessary interest on an audit overpayment only requires entering the principal amount of the refund into the calculator and using the appropriate interest dates through which to calculate the interest. Entering payments in this scenario will only reduce the overpayment interest base, since the calculator will apply the payment to it as if it were an audit liability.

For an overpaid audit, the interest start date is the later of the statutory filing due date (not considering filing extensions), the actual filing date, or the date the return became overpaid. IAC §100.9400(c)(3) defines the "date of overpayment" as:

- The original due date of the return without regard to the automatic extension, the date final payment is made, or the date the original return is filed, whichever is later.

- The date the claim was filed in the case of a federal capital loss carryback, or the carryforward of Illinois net losses and investment credits (unless the refund is issued within three months of the date of the claim).

- The last date of the loss year if the claim is due to an IITA §207 Illinois net loss carryback from a loss year ending prior to December 31, 2003.

If a taxpayer filed its calendar 2005 IL-1120 on 2/15/06 and the due date without extension was 3/15/06, then the *Original Due Date* used would be 3/15/06. If the taxpayer filed that return on 11/13/06, then the date of overpayment would be 11/13/06 and entered in the *Original Due Date.*

In the simplest scenario, a taxpayer would have filed an original return and paid its liability or received a refund with no subsequent payments after filing. When the claim is established in the audit, the interest for that APE would be calculated on the overpaid amount from the date of overpayment through the IL-870 date. See Example B below.

Example B: Same facts as Example A above, only the auditor now establishes a claim during the audit of $2,500, which reduced the tax reported of $10,000 to an audit tax of $7,500. To calculate the interest on the claim, you should determine

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the refund basis, which would be the $2,500 claim (Column B change on EDA-25), and compute interest from the date the original return was filed through the IL-870 date.

When there has been activity such as amended returns filed and subsequent payments, then you must look at the payments that created the overpayment and calculate interest on each "segment" of the audit overpayment based on those payments, starting from the most recent payment first and working backwards chronologically. See Example C below.

Example C: Same facts as Example A, only after timely filing the original 2008 return showing a $10,000 tax, Taxpayer filed an IL-1120-X reporting a total tax of $12,500 and made an amended payment of $2,800 on 3/15/10 ($2,500 tax + $250 late-pay penalty + $50 interest). During the audit, the auditor determines that the correct reportable tax is $9,000. This reduction in liability means that no late-payment penalty or underpayment interest was due. Under IAC §100.9400(c)(2), the $250 late-payment penalty and $50 in underpayment interest are included in the overpayment for purposes of computing interest, so this change creates an audit claim of $3,800. Since there has been a subsequent payment, the auditor will need to look at the payment activity starting from the most recent and calculating interest from the dates of the payments through the IL-870 date that contributed to the taxpayer being overpaid $3,800. Therefore, the auditor would calculate interest on $2,800 from 3/15/10 through the IL-870 date. That leaves $1,000 to calculate from the next most recent payment. This occurred from the original return payments, but we must use the later of the original return due date, date it was overpaid, or the received date of the original return. Therefore, interest is calculated on $1,000 from 10/15/09 through the IL-870 date.

Note: The original characterization of the $2,800 payment made on 3/15/10 is ignored. The payment is just a payment with no emphasis placed on whether it was made to satisfy liability, penalty, or interest.

The following steps, including screenshots, provide general guidance for using the P&I Calculator. Keep the above-mentioned information in mind while going through these steps. While Examples A, B, and C will be referenced in this section, more illustrative examples are provided in the Penalty & Interest Calculations-GenTax section. Lastly, this section mainly focuses on audit liability accounts, because it is more complex and requires more information input into the calculator. Understanding all the fields used for calculating an audit liability will also help explain how to calculate an audit claim. Calculating interest for claims is discussed at the end of this section.

B. Calculating Penalty & Interest

The Penalty & Interest Calculator can be found on the Navigation Panel:

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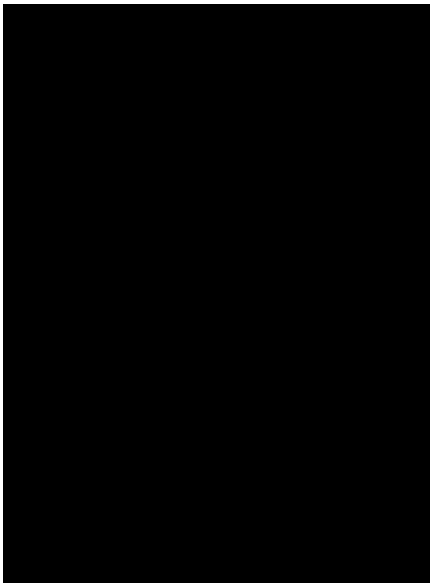
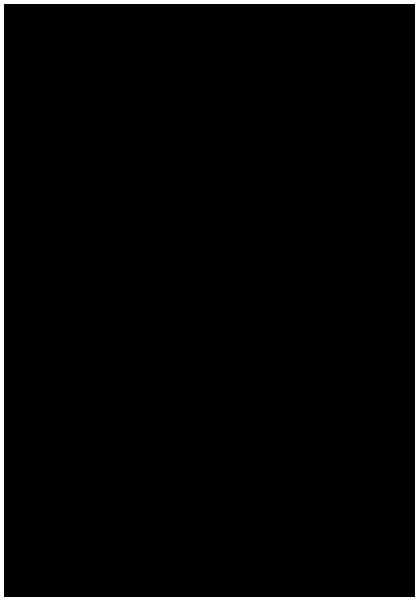
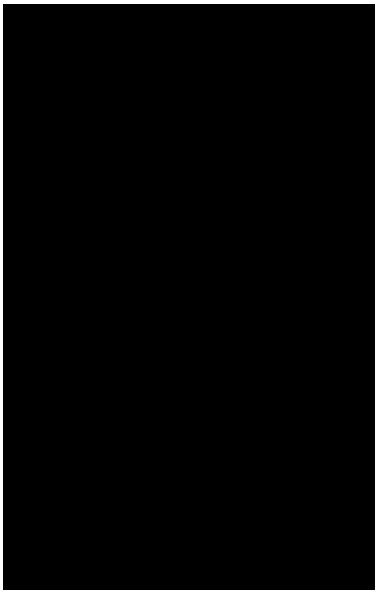
- When any account is accessed
- When any period is accessed
- When an audit is accessed







From here, click on *P&I Calculator*. This will bring the P&I Calculator into context.

1. Period Info Section

The *Period Info* section must be completed first. This will allow the computation of penalty, if applicable. Each tax period must be calculated separately. We will use Example A to complete this section.

A. Enter the original due date in the *Original Due Date* field.
B. Enter the date the original return was filed in the *Return Rcvd Date* field.

The *Return Rcvd Date* field is not a required field. However, there are instances when the field will require input for proper calculation of penalties and/or interest.

1) Penalty
The *Return Rcvd Date* field on the *Main* screen of the P&I Calculator is linked to the *Date Return Received* field on the *Late File Calculation* screen under the *Penalty* tab. Anytime a date is input in the *Return Rcvd Date* field on the *Main* screen, the *Date Return Received* field on the *Late File Calculation* screen will automatically populate.

A Late File Penalty will automatically be calculated whenever the date entered in the *Return Rcvd Date* field is later than the date entered in the *Original Due Date* field or if it is left blank.

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To properly calculate the Late File Penalty with the P&I Calculator, the *Return Rcvd Date* field should be used in conjunction with the *Use Extended Due Date* and *Extended Due Date* fields on the *Late File Calculation* screen. Anytime a return is received prior to the automatic extension date for filing, the *Use Extended Due Date* should be checked and *Extended Due Date* should be populated with the automatic extension date for proper calculation of the late file penalty.

2) Interest
The *Return Rcvd Date* field on the *Main* screen of the P&I Calculator is also linked to the *Rfn Issued* field on the *Refund* screen under the *Payment/Refund* tab.

The P&I Calculator will not take into consideration any refunds reported on the *Refund screen* that have a *Rfn Issue* date prior to any date input in the *Return Rcvd Date* field when calculating interest.

Since most refunds are not issued prior to receiving a filed return, this is especially significant whenever there are amounts entered on the *Refund* screen that represent credit carryforwards. Whenever there are refunds that represent credit carryforwards, the *Return Rcvd Date* should be left blank.

Because of these requirements, it may not be possible to calculate both the proper Late File penalty and bal due interest at the same time. The P&I Calculator would be more useful in calculating the more complex interest issue than a penalty that could be calculated manually.

C. Enter the *Amount Due*, which is the total tax required to be shown. Again, remember that the *Amount Due* is the correct tax after the audit is performed (e.g. Column C total tax from EDA-25).
D. Enter any refund under *Amount Refunded*, which in Example A is zero (see next section for further explanation of the field). Below is a screenshot of the *Period Info* Section:

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[redacted]

E. The *Amount Refunded* field is for entering overpayments refunded, offset, or applied as credits to another year or liability. The auditor will have to determine if any refund has been issued and if any interest was included in the refund. **The entire amount refunded should be included in the *Rfn Amount* field less any interest properly due to the taxpayer. Do not use the *Rfn Interest* field.** This will incorrectly increase the late-payment penalty base by the refund interest amount (the calculator "thinks" of refund interest as tax), and you will need to override the penalty base or manually calculate the late-payment penalty. If the overpayment was applied as a credit carryforward, the date the credit carryforward was applied should be entered. The date the credit carryforward was applied can be found under the *Transactions* tab in the Period springboard for the subsequent year and is the date found in the *Effect* column. This information should be entered by clicking on the tab labeled *Payment/Refund* and then the *Amount Paid* tab. For example, if the original return was filed on 10/15/09, a refund had been issued for $2,017.26 on 9/1/10, and $17.26 was the interest portion, this is what would be entered:

[redacted]

To return to the main screen from any detail screen, click on the *Main* tab.

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The *Rfn Issued* field is for the date the refund is issued. To find the date the refund was issued, click on the Refund tab in the Period springboard. The Refund Status should show "Issued by Comptroller". Click on the Refund hyperlink. This screen shows the refund issued date. If there is no refund issue date, then the refund has not yet been issued.

Rfn Amount is for the total overpayment refunded, <u>including refund interest net of interest properly due to taxpayer</u>. Again, **do not use** the *Rfn Interest* field (it currently leads to incorrect interest calculations because it will double the reclaimed interest in Amnesty situations and not accrue interest on the reclaimed interest). Lastly, the received date of the original return entered on the main screen will also be utilized when overpayments were originally issued in audit liability situations.

An offset to another period, tax, or liability with another agency should also be entered as a refund. If there is a fee, such as a collection fee, then that should be entered as part of the *Rfn Amount*. Shown below is an offset for an IRS liability. The amount entered in *Rfn Amount* would be $524, which includes the IRS Intercept fee.

F. Payments can be included by clicking on *Amount Paid* tab, and then entering each payment manually by entering the payment date (which is the "Effect" date

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in the Transactions panel) and then the payment amount. If a payment has been entered in error, the box in the *Pymt Invalid* column can be checked to invalidate the payment, or the amount can be deleted. However, once a payment has been entered, if no payment should have been entered, the *Pymt Invalid* box should be checked. If you find that this makes the payment screen look cluttered, a date should be left in the *Pymt Rcvd* field and the *Pymt Amount* can be deleted. Otherwise, the P&I Calculator will indicate there is an error with the payment information by placing a red exclamation point icon next to the *Amount Paid* tab. Like refunds, payments cannot be entered on the main P&I Calculator screen since this is not an active field.

For payments and returns processed in GenTax, auditors should be able to search for them in GenTax. For prior years, not all converted taxpayers have payment details, and taxpayer payments not converted will need to be located in IRIS. By clicking the *Amount Paid* tab you can see the payment detail for any payments you have already entered as well as adjust the payments. Shown below is a screenshot of the *Amount Paid* screen with several payments entered:

There are a host of different payment types that could be applied to the account. In GenTax, they can be located under the taxpayer's Period springboard under the Transactions tab. Any payment will appear in parentheses under the amount column. For example, below is shown the Transactions panel of a taxpayer.

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The taxpayer had a credit carryforward from the previous year and four estimated payments applied to the tax period. The *"*Trans Type*"* explains what type of payment it was. Other examples could be an SOA payment, Audit, Misc., or a Xfr- Credit In, etc. The "Effect" date is the payment date that should be used for the P&I Calculator.

EXCEPT for credit carryforwards going to a subsequent period. The date they are needed for the subsequent periods estimated payment(s) obligation should be used.

Individual Income Tax (IIT) and Business Income Tax (BIT) have a major payment difference with GenTax. For BIT, GenTax shows the original tax in the Transactions panel net of credits (investment and income tax credits). For IIT, however, GenTax shows the tax net of credits except for Earned Income Credit (EIC) and withholding. This means that, for IIT audits, the auditor will have to enter any EIC credit and withholding as a payment in the P&I Calculator. An EIC credit should be divided by four and entered quarterly as if it were 4 timely ES

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payments. For example, an EIC credit of $500 for calendar year 2007 would be entered in the P&I Calculator as four timely $125 ES payments. Withholding should also be divided by four and entered as 4 timely ES payments. Again, GenTax will show these as it would other payments in the Transactions panel, with an “Effect” date and the amount in parentheses. Shown below is an example of an IIT account with an EIC credit and withholding, and how the EIC credit and withholding would be entered as payments and the results on the P&I main screen using the “Original Tax” of $680:

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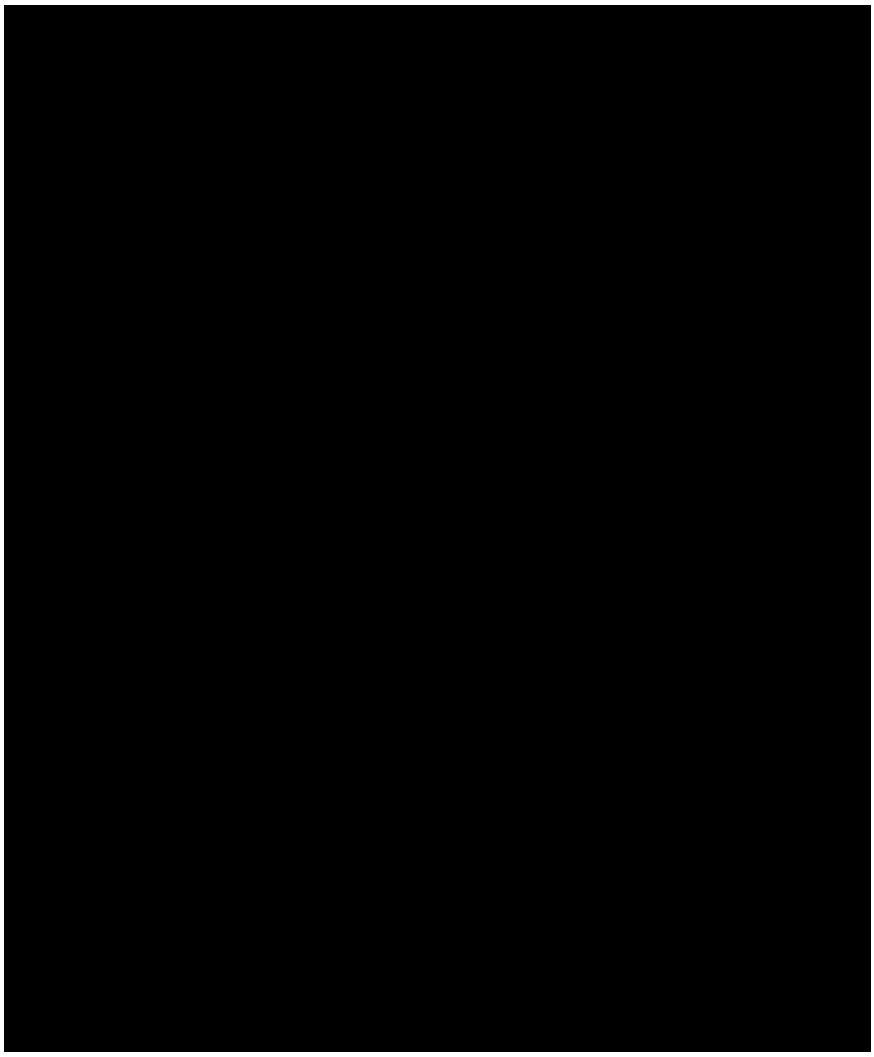

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2. Penalty Section

The second section of the P&I Calculator is the *Penalty* section. For a thorough explanation of the following penalties, please refer to Publication 103 and Penalties section of Chapter 42. Based on the information entered in Example A under "Audit Liabilities", for Company A, the *Penalty* section will populate as shown below:

More information needs to be input into each penalty so that the correct penalty is calculated. This can be done by clicking the tab or hyperlink for each penalty or selecting the specific penalty by clicking on the paper icon.

A. The *Late File* detail screen would be completed as follows:

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Original Due Date - links from the main screen, should already be populated if entered on the main screen
Use Extended Due Date - box should be checked
Extended Due Date – enter the extended due date
Date Return Received - links from the main screen, should already be populated if entered on the main screen.

The calculator will then calculate the appropriate late-file penalty, which in this example is now zero. However, a return filed after the extended due date showing an amount due would generate a late-file penalty.

B. The *ES Late Pay* penalty is the late-payment penalty for underpayment of estimated tax.

You will need to go to the detail screen by clicking on the tab and selecting the ES detail screen. You must then enter the required quarterly estimated payment under *Amount Due*. This then multiplies that payment by four and populates the *Total ES Base*. The P&I Calculator does not allow adjusting required payments if the taxpayer uses the annualized method. In those instances you would have to use the IL-2220 (businesses) or IL-2210 (individuals). IAC. §100.8010(i) requires that ES payments be made for short tax years beginning on or after 1/1/11. This type of situation, also, cannot be computed using the P&I Calculator and should be handled manually on an IL-2220 or IL-2210. After entering the required estimated payment, then you must enter the four ES payment dates. Now the calculator can determine if any ES Late Pay penalty should have been assessed. The ES Late Pay penalty is a complex penalty, so it is recommended that you review Publication 103 and discussions within Chapter 42, and discuss any difficulties with your supervisor and Technical Support. In general terms, to calculate the required quarterly payment, you must calculate the "ES Late Pay base" and divide by four. The ES Late Pay base for BIT accounts is based on the total net income and replacement taxes shown on the original return. The ES Late Pay base for IIT accounts is based on total tax less credits (CR, PT, ED, 1299-C, and EIC credits). The taxpayer must pay <u>the lesser</u> of 100% of the prior year's tax base or 90% of the current year's tax base through timely ES payments.

Back to Example A, assuming this year's tax base is lower and no credits, the ES Late Pay base would be 90% x $10,000, and the required quarterly payment would be $2,250 ($9,000/4). The auditor must input the required quarterly $2,250 ES payment in the *Amount Due* field, and the four ES payment due dates in the four *Pmt Due* fields. Remember that fiscal filers will have different ES payment dates (still 15th day of 4th, 6th, 9th and 12th months for corporations and 15th day of 4th, 6th, 9th, and 13th month for individuals). Below is the ES/liability due date chart from Chapter 33(21) of the Audit Manual:

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Due dates for Estimated Payments & Returns for Individuals and Corporations

	Individuals and Corporations			Corp	Ind	Corp *	Ind
YEAR ENDING	1st Inst DUE	2nd Inst DUE	3rd Inst DUE	4th Inst DUE	4th Inst DUE	RETURN DUE	RETURN DUE
1-31	5-15	7-15	10-15	1-15	2-15	4-15	5-15
2-28	6-15	8-15	11-15	2-15	3-15	5-15	6-15
3-31	7-15	9-15	12-15	3-15	4-15	6-15	7-15
4-30	8-15	10-15	1-15	4-15	5-15	7-15	8-15
5-31	9-15	11-15	2-15	5-15	6-15	8-15	9-15
6-30	10-15	12-15	3-15	6-15	7-15	9-15	10-15
7-31	11-15	1-15	4-15	7-15	8-15	10-15	11-15
8-31	12-15	2-15	5-15	8-15	9-15	11-15	12-15
9-30	1-15	3-15	6-15	9-15	10-15	12-15	1-15
10-31	2-15	4-15	7-15	10-15	11-15	1-15	2-15
11-30	3-15	5-15	8-15	11-15	12-15	2-15	3-15
12-31	4-15	6-15	9-15	12-15	1-15	3-15	4-15

- Effective for years ending on or after December 31, 1976

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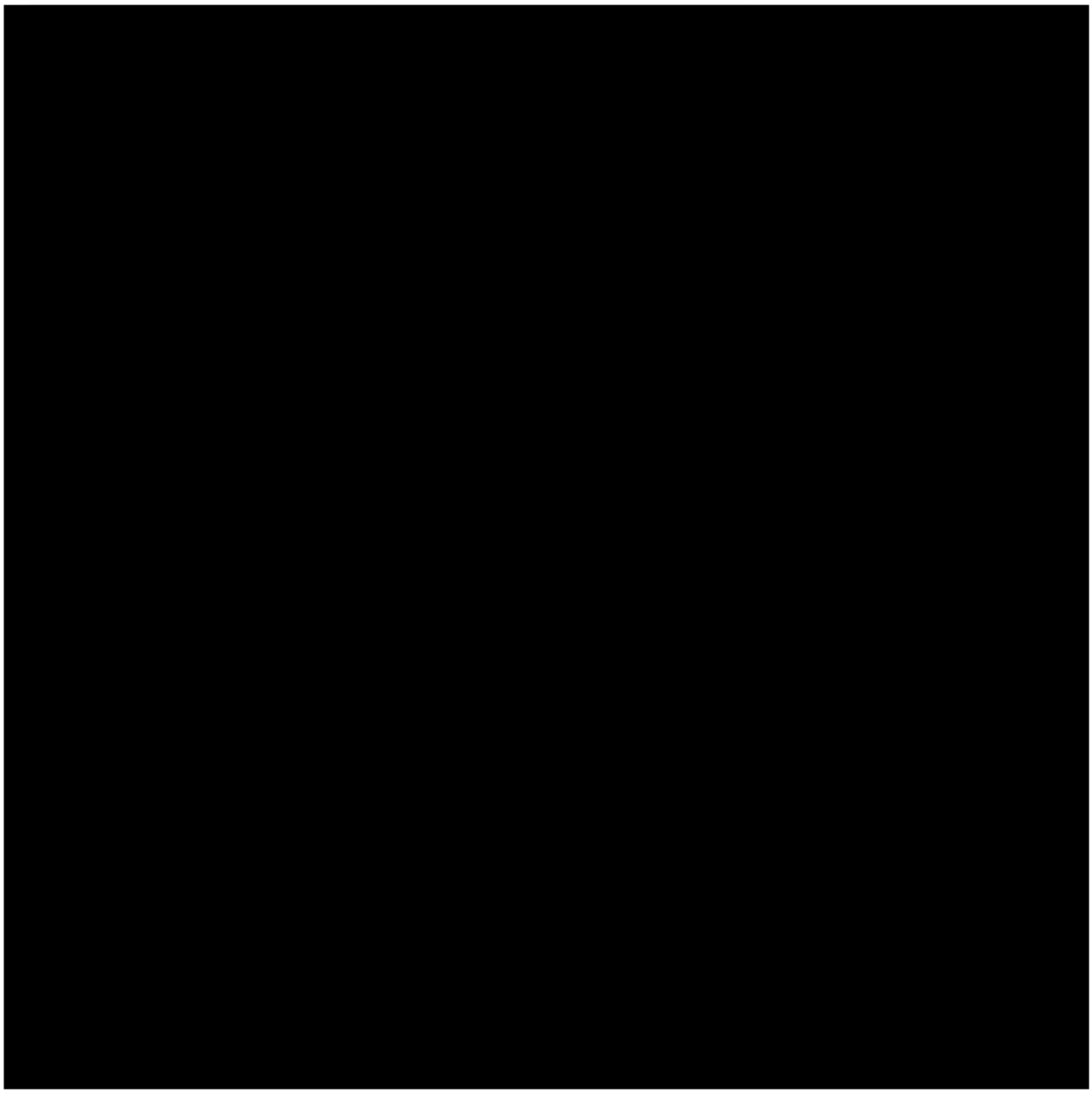
Below is how the P&I Calculator ES detail screen would appear from Example A:



In Example A, no ES Late Pay penalty would have been assessed because the screen links to the payment screen to determine if the required estimated payments have been made.

C. *Late-Payment Penalty*

Based upon the information already input, this penalty should now be calculated using the respective UPIA rate. The *Use OverRide Amount* box can be selected to change the penalty base amount under the *Balance* column, if necessary. It is important to remember that for periods during

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UPIA I-3 (1/1/94-12/31/03), the auditor does not calculate the late-payment penalty for the IL-870.

Below is the detail screen for the late-payment penalty:

For UPIA 5 (returns due on or after 1/1/05), the additional audit 5% penalty can be calculated by checking the box under *Include Audit Late Payment Penalty*. The *OverRide Amount Indicator* box can be selected to change the penalty base amount under the *Balance* column, if necessary. Below is the detail screen *Audit Late Payment Penalty*:

Returning to main P&I Calculator screen, the *Penalty* section would now look like this:

The total audit late-payment penalty is 15% of the audit liability, and using the calculator you will have to add both the *Late Payment* and *Audit Late Payment Penalty* fields to calculate the 15% UPIA 5 late-payment penalty to be shown on the IL-870. **For returns due prior to 1/1/05, the *Audit Late Payment Penalty* field should not be used; it**

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will incorrectly populate with the penalty under *Late Payment*. That field exists solely to add the 5% additional penalty for payments made after an audit has begun under UPIA 5. For earlier UPIAs, the late-payment penalty was not altered because of an audit initiation, so the *Audit Late Payment Penalty* field is irrelevant for UPIAs prior to UPIA 5. For those earlier UPIAs, the P&I Calculator will calculate the late-payment penalty based upon the appropriate rates for each UPIA, and populate that amount in the *Late Payment* field solely.

Also, the *Penalty* section will calculate what the total penalties should be, including penalties that were already assessed and perhaps paid by the taxpayer. You will have to verify on the GenTax Account springboard what penalties were already assessed and paid. The taxpayer should never be assessed the same penalty on the same penalty basis twice. For example, if in Example A, the taxpayer had made no ES payments and was assessed a ES Late Pay penalty of $900, that $900 should not be proposed on the IL-870. Under such circumstances, you can manually change the penalty bases in the calculator, or simply do your penalty calculations without the P&I Calculator. It is always a good idea to manually calculate the audit penalties to compare to the calculator results. Also, the penalties that are calculated by the P&I Calculator that relate to penalties assessed prior to the audit should equal what would be calculated on the forms IL-2220 and IL-2210. **Remember, the only penalties put on the IL-870 should be those associated with the audit liability and protestable. Except in the case of nonfilers, this should only be the appropriate UPIA late-payment penalty for the audit liability.**

There are certain fees that are not captured by the P&I Calculator, such as collection, lien, and NSF fees. These would never be assessed by the auditor, but may have penalty and interest that will be calculated by the Account springboard without inputting those fees. Any discrepancy in total balance due because of those fees would only calculate once the account is adjusted by Audit Perfection, and should only be minimal.

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Below is a screenshot with an assessed collection fee:

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3. Interest Section

The *Interest* section contains the fields to enter the date through which interest is to be calculated, broken down as short-term interest, long-term interest, and total interest.

A. To calculate interest, enter an *Interest Thru* date. For audit purposes, this will normally be the IL-870 issuance date. Continuing Example A, let us say that the IL-870 issuance date is 6/1/11. That will be the date you enter in the *Interest Thru* field as shown below and the interest will populate the appropriate fields:

B. You can see the breakdown for short-term, long-term, and total interest by clicking on the respective tab. Below is the detail screen for *Total Interest:*

Note: The "rate" shown above is the actual interest rate for each period divided by 365 days (366 for leap years starting in 2012, see Paragraph C. below concerning leap years). This yields the daily interest rate for each period. For example, in the interest detail screen shown above, the taxpayer's daily interest rate from 3/16/09 through 6/30/09 was .00005479, which is the annual rate of 2% divided by 365 (.02/365=.00005479).

C. For leap years 2008 and prior, the P&I Calculator only computes interest based upon the yearly rate divided by 365 days. For 2012 and forward, this problem was fixed and will correctly be calculated dividing by 366 days. Management has determined that the interest difference for past leap years is "de minimis" and can be ignored.

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4. Amnesty Section

The last section of the P&I Calculator is *Amnesty*.

A. *Interest on Penalty* will automatically be computed on the liability base for returns due on 1/1/94 through 12/31/00. If there is an amount reflected in the *Interest on Penalty* box, this amount will have to be subtracted from the *Total Interest* amount to know the amount of interest on tax.

B. If the period is an Amnesty qualified year, a checkmark automatically appears in the *Is Amnesty Period* checkbox.

C. If the taxpayer failed to participate in Amnesty, checking the *Amnesty Denied?* checkbox will double all penalty and interest shown on the calculator. You will have to verify if there was any previously assessed penalty and interest, and may have to manually compute the IL-870 amounts that are associated with the audit liability and protestable. Therefore, you should only use the *Amnesty Denied?* feature when the taxpayer did not have any previously assessed penalty and interest prior to the audit. Otherwise you will overcharge the taxpayer. Shown below is the *Amnesty Section:*

Note: The *Is Amnesty Period* box is determined by the date put in the *Original Due Date* field. That means that fiscal filers with original due dates on 7/1/09 and after will not automatically populate the *Is Amnesty Period.* For example, taxable year ending 5/30/09 is a period that qualifies under 2010 Amnesty. However, since its original due date would be 8/15/09 (after 7/1/09), the P&I Calculator will not automatically recognize it as an Amnesty year, since it incorrectly compares the *Original Due Date* to 7/1/09. For FYE 4/30/09, 5/31/09, and 6/30/09, you will have to manually compute the Amnesty impact.

Once everything is calculated, determine the applicable audit portion of *Total Penalty* & *Total Interest* figure. The following example continues Example A. It is assumed that the taxpayer did not participate in the 2010 Illinois Amnesty Program, so interest and penalty will be doubled.

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In Example A, the taxpayer timely filed and paid its originally filed liability, including estimated tax. The only penalty and interest calculated are for the audit liability. Therefore, we do not have to adjust the interest or penalty calculations and can safely click on *Amnesty Denied?* to double penalty and interest. If the IL-870 issuance date was the interest date of 6/1/11, then the total audit penalty would be $1,500 (15% x 2 x $5,000) and total interest doubled per Amnesty would be $573.16. If the taxpayer failed to pay within 30 days of 6/1/11, then the taxpayer would be assessed the audit penalty at 40% (20% x 2) when billed from Technical Review and the interest would continue to accrue until the liability is paid. Do not give the taxpayer another IL-870 showing the result of the penalty increasing to 20%.

For returns due on and before 12/31/00 (UPIA 1-2.5), interest accrued on both tax and penalty. When using the calculator for these years, the interest in the *Total Interest* will include the total of liability and penalty interest. The field *Interest on Penalty* will show the interest only on penalty. Therefore, to itemize the interest on tax and penalty, the

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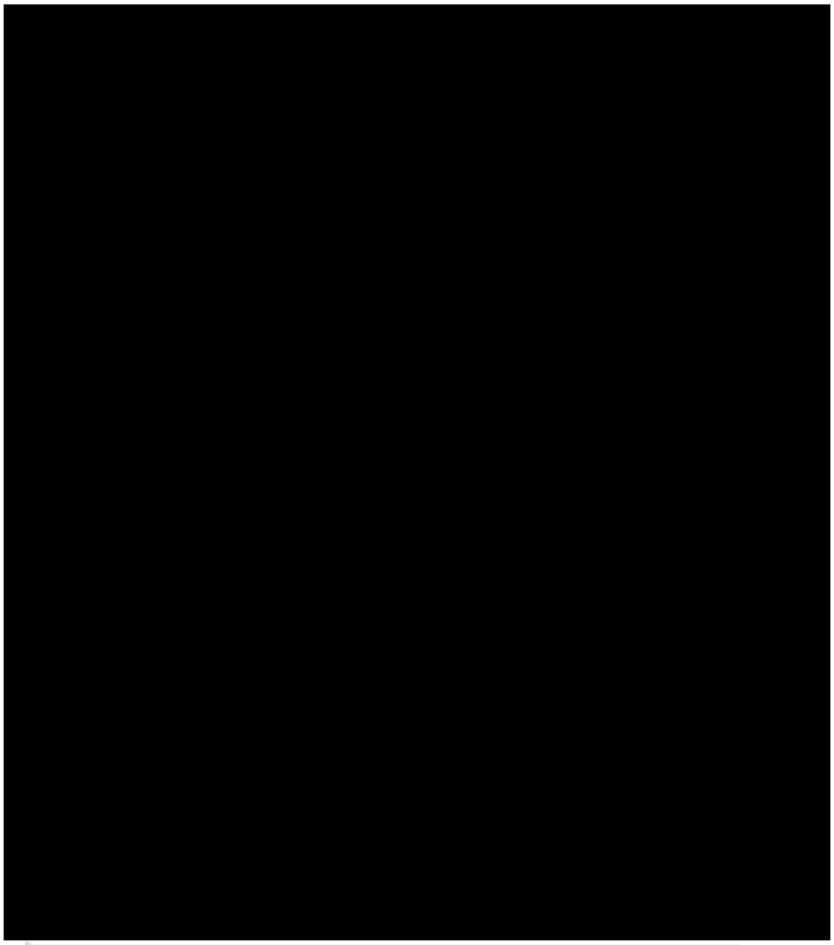
Interest on Penalty should be subtracted from the *Total Interest*. The *Interest on Penalty* should not be added to the *Total Interest*, since it is already included. For example, if in Example A the APE was changed to 12/99 and the previous payments and return were filed timely, then the account would calculate as shown below:



The total interest on both tax and penalties is $9,330.09, which results from doubled penalty and interest for not participating in the 2003 Amnesty. To compute the interest on tax liability, subtract the *Interest on Penalty* amount from the *Total Interest* amount. In the above example, the interest on tax liability would be $6,664.98 ($9,330.09-$2,665.11).

The auditor will be expected to save their final GenTax P&I Calculator calculations for each period of the audit as Excel files with the other audit package schedules and as attachments to the taxpayer's GenTax Audit springboard. This must be done for each period with liability interest and refund interest. Attaching the files to the GenTax Audit springboard will save the auditor from having to print dozens of Excel workbook pages to include in the audit file, as well as allowing the rest of the Audit Division convenient access to the auditor's calculations.

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To save as an Excel file, you will need to click on the “Export” icon shown on the top right panel bar (shown below) and then under the “Export” menu select “Excel”.

Once exported to Excel, all the available screens on the P&I Calculator can be accessed through different worksheet tabs, with the primary screen being labeled as “Main”. This is shown below:

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Here the auditor could print any P&I Calculator screens, if desired. The auditor should now name and save the Excel workbook to the audit file. Once the files are saved, they can be attached to the taxpayer's GenTax Audit springboard. This can be done by following the steps below:

A. From the taxpayer's Audit springboard in GenTax, click on the **CRM** tab, then click on the **ATTACHMENTS** tab.

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B. Next, click on **ADD** under the **ATTACHMENTS** tab shown above. This will open the window shown below

C. Select "Auditor Attachment" under the Type field. Next click on the Ellipsis button and search for the file under "File Name" in the appropriate folder it was saved. Then, fill in "Short Description" with an appropriate name for the attachment (e.g. 2007 P&I Calculation). Lastly, click on "Save".

D. Now the Excel file will be displayed as an attachment. To access it, click on the "File Name" hyperlink. The panel shown below opens. To open and view the attachment, click on **View File**, shown below or click on the File Name hyperlink in History:

E. The attachment will open for viewing in a separate window.

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C. Calculating Audit Refund Interest

Now that the calculator fields have been described for liabilities, there should be some familiarity with each one. However, calculating refund interest will require a slightly different approach using only certain fields of the calculator. These fields are:

- *Original Due Date* – Date of overpayment.
- *Amount Due* – Refund amount accruing interest.
- *Interest Thru* -- Stop-date for interest, the IL-870 issuance date.

No payments should be entered. Figures that appear in *Penalty* section should be ignored. The *Amnesty* section is also unnecessary for calculating refund interest, since refund interest for all Amnesty periods is always single interest. Below are Examples B and C from "Audit Claims" section with screen shots.

Example B: A claim was established in audit after the auditor determined that the tax required to be shown was $7,500, not the $10,000 originally filed by the taxpayer. Since there are no subsequent returns or payments to consider, the auditor needs to calculate interest on the whole overpayment of $2,500 from the date of overpayment to the IL-870 issuance date. Let's assume an IL-870 date of 6/1/11. The date of overpayment is the later of the original return due date without extensions, the date of payment that created the overpayment, or the date the original return was filed. The liability was paid timely (by 3/15/09), the due date is 3/15/09, and return was filed on the extension date of 10/15/09, so 10/15/09 is the date of overpayment and will be entered in the *Original Due Date* field. Next, without different overpayment dates to consider, the refund can be calculated in one segment, so $2,500 should be entered in the *Amount Due* field. Lastly, the calculator computes interest through any date entered in the *Interest Thru* field. For completing the IL-870 and audit, the auditor should use the IL-870 issuance date. In this example, it would be 6/1/11. Below is a screenshot of the Main Screen showing refund interest of $77.33:

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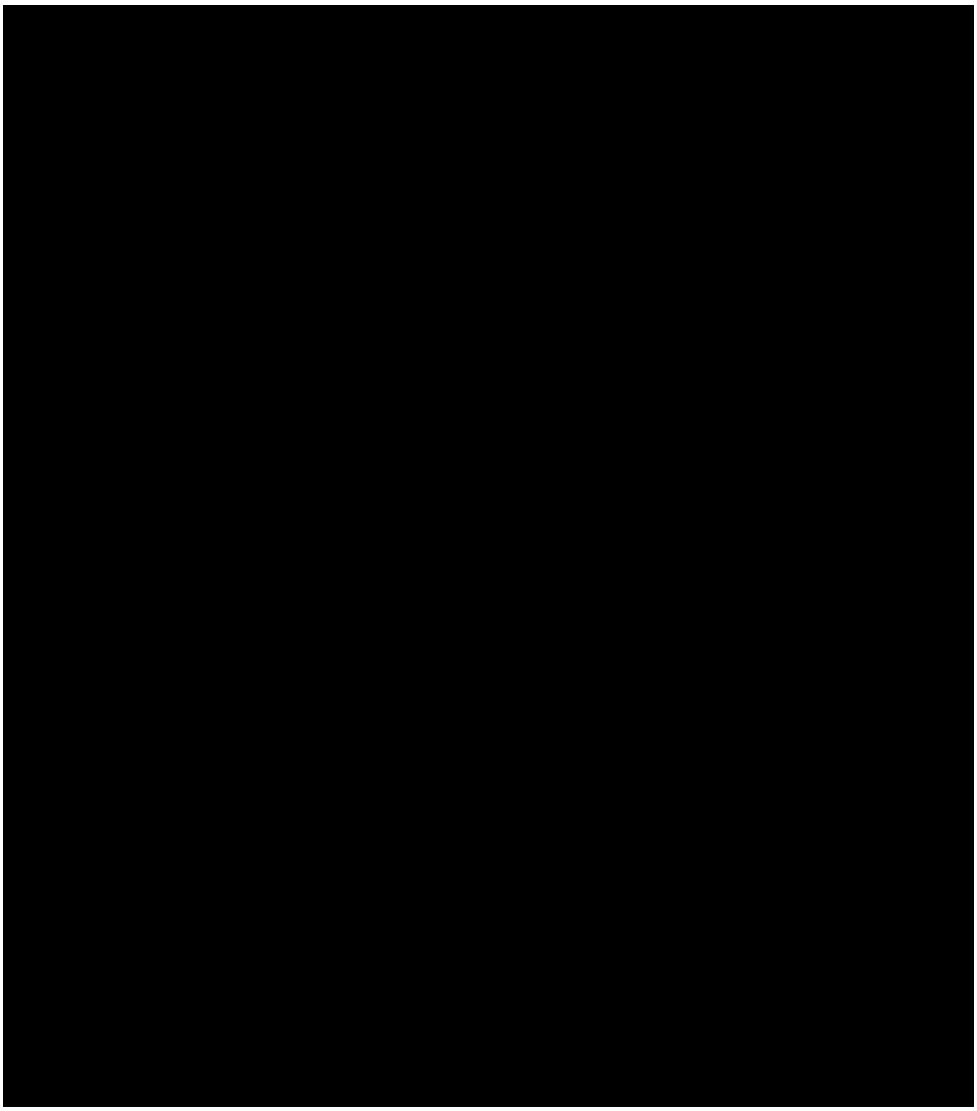

Example C: The 2008 IL-1120 tax originally reported was $10,000. The taxpayer then filed an amended return reporting a higher tax of $12,500 and made an amended payment of $2,800 that included penalty and interest on 3/1/10. During the audit the auditor reduced the correct tax to $9,000. This created a tax change of $3,500, and a total overpayment of $3,800. However, the interest for the $3,800 must be calculated in segments because it became overpaid at different times due to subsequent payments. The auditor must work backwards from the most recent payment, which is still following the "date of overpayment" principal. $2,800 of the $3,800 became overpaid on 3/1/10, which was the payment made with the amended return. Interest will need to be calculated on $2,800 from 3/1/10 to the IL-870 date of 6/1/11. Interest on the remaining $1,000 ($3,800-$2,800) was overpaid when the original return was filed, so it will be calculated from 10/15/09 to 6/1/11. Then those two interest amounts should be added together and reported on the IL-870 for APE 12/31/2008. The total interest is $75.50 ($44.57 + $30.93) and is shown on the screenshots below:

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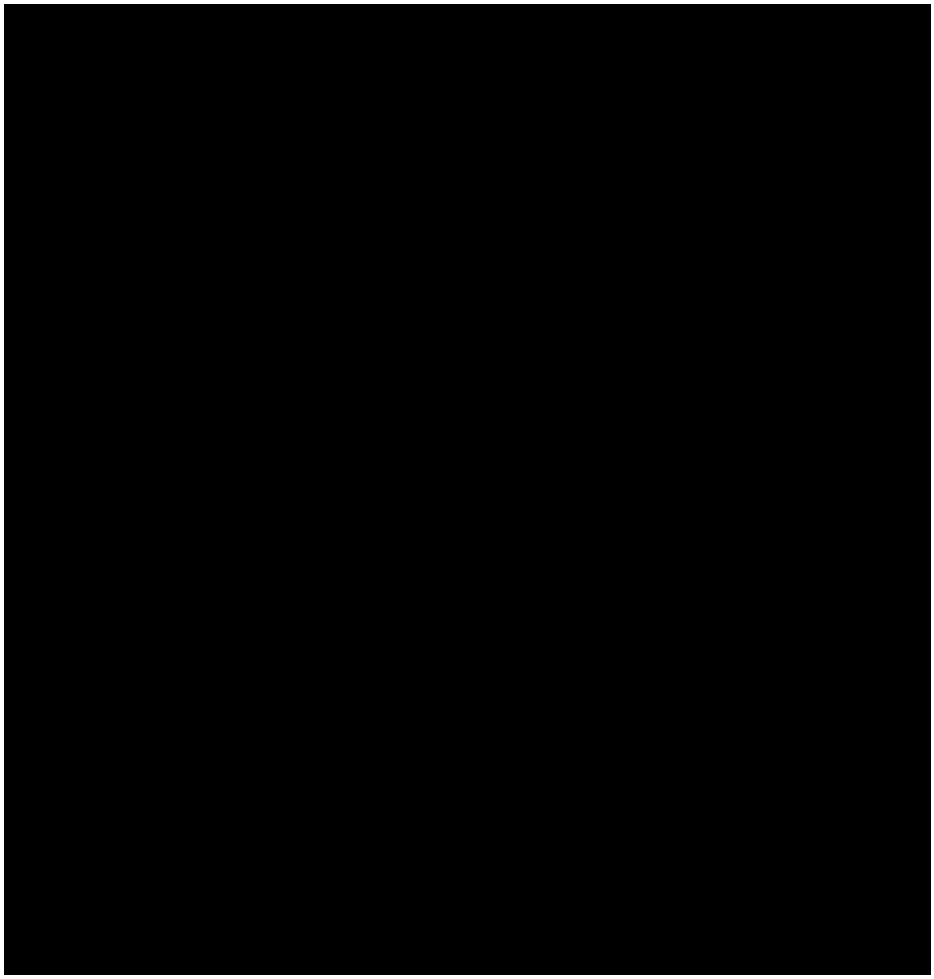

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D. Penalty and Interest Calculations – GenTax

The following are examples that illustrate using the P&I Calculator and including those amounts on the IL-870 (the "IL870M, Manual Waiver of Restrictions" form found under the GenTax audit letters should be used). The examples are not an exhaustive list of situations that will arise during audits, but will illustrate several possible situations. Further information concerning interest and penalties on overpayments and liabilities can be found in IITA §909, UPIA §3-2, IAC §100.9400, and Publication 103. Any questions concerning these computations and the IL-870 should be discussed with your supervisor and Technical Support.

A comment should be added to the Remarks section for any penalty and interest doubled on a liability for failure to participate in the 2003 and 2010 Amnesty Programs. Also, whenever the amount due or overpayment is different than the IL-870 total, the actual amount owed or to be refunded should be stated in the Remarks section. See the examples for recommended verbiage in various situations.

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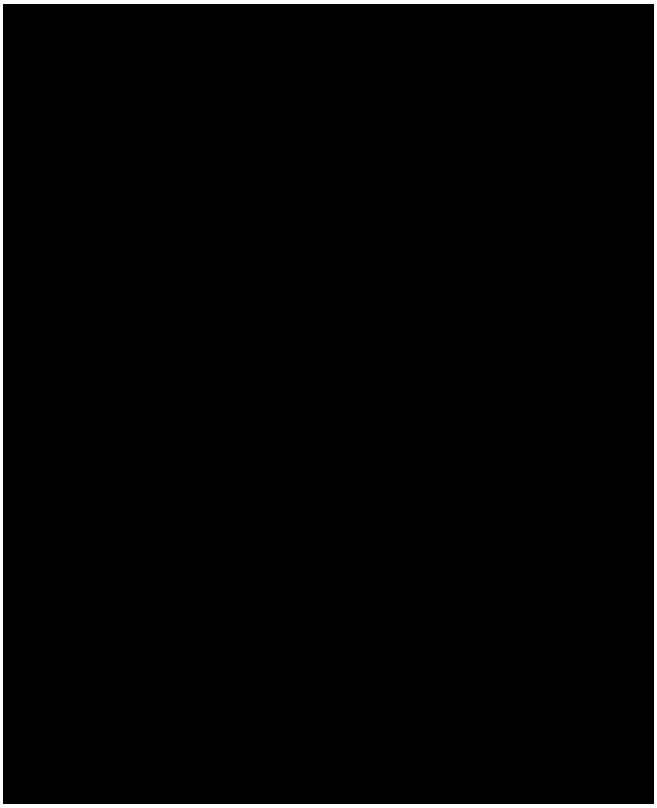
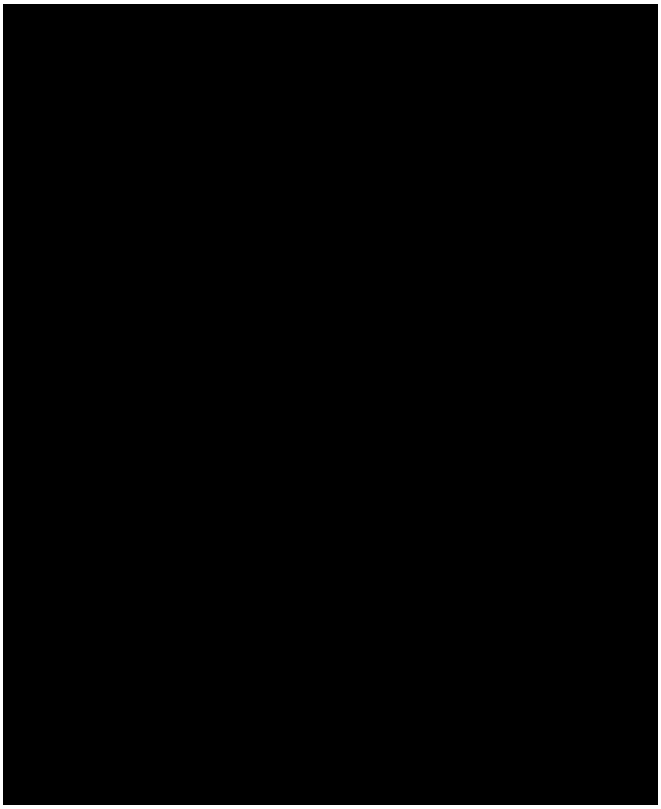
Each example is labeled with a general description to allow for easier identification for future reference.

1. Audit Liabilities

Taxpayer timely filed its 2007 and 2008 calendar year IL-1120s on 10/15/08 and 10/15/09, respectively. Its originally filed 2007 tax of $10,000 was paid by four timely ES payments of $2,250 each, and a timely $1,000 IL-505-B extension payment. Its originally filed 2008 of $12,000 was paid by four timely ES payments of $2,700 each, and a timely IL-505-B extension payment of $1,200. In 2011, an audit was conducted and established an audit liability for each year, $5,000 in 2007 and $1,000 in 2008. Lastly, Taxpayer did not participate in Amnesty. In preparing the IL-870, the P&I Calculator should be used to determine the penalty and interest due for Taxpayer for each APE. The 2007 *OriginalDue Date* would be 3/15/08 and 3/15/09 for 2008. The *Interest Thru* date is the issuance date of the IL-870, or 6/1/11 in this example. Since the interest and penalty will be doubled for failure to participate in Amnesty, the following comment should be added to the Remarks section: "Penalty and interest amounts reflect double rates for failure to participate in 2010 Amnesty Program." Lastly, since no prior penalty or interest was assessed on the account, the penalty and interest calculated will only be for the audit liability, which will be the amounts to put on the IL-870. Using this information in the P&I Calculator, this is what the GenTax P&I Calculator would show for each year and the completed IL-870 from GenTax:





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Taxpayer Information

Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/07	$5,000.00	$1,500.00	$1,131.78	$7,631.78
12/31/08	$1,000.00	$300.00	$114.63	$1,414.63
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$6,000.00	$1,800.00	$1,246.41	$9,046.41

Remarks

Penalty and interest amounts reflect double rates for failure to participate in 2010 Amnesty Program.

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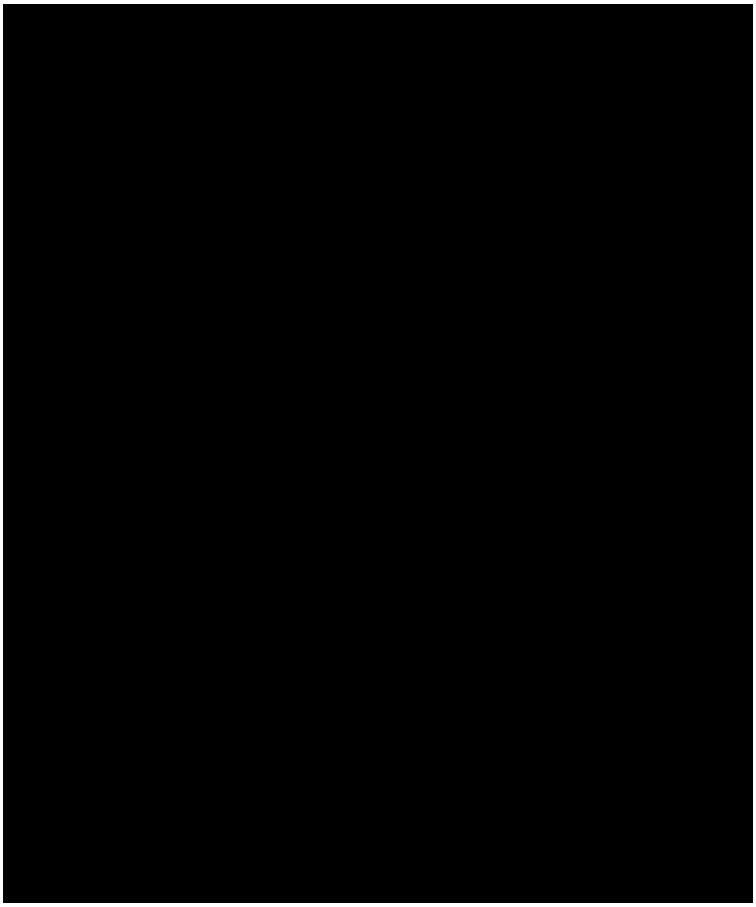
2. Audit Liability and Audit Claim, Net Liability

The same facts as above for the original returns. In 2011 an audit was conducted and established a $5,000 audit liability for tax year 2007 and a claim of $2,500 for 2008. Taxpayer agrees to audit results. The issuance date for the IL-870 is 6/1/11. Taxpayer did not participate in 2010 Amnesty. Lastly, since there was no previously assessed penalty or interest, no manual calculations will need to be done after using the calculator. The P&I Calculator should be used to determine the interest due on the 2007 underpayment of $5,000 computed using an *Original Due Date* of 3/15/08 through the *Interest Thru* date of 6/1/11, the IL-870 issuance date. This would then be doubled for failure to participate in Amnesty. Second, the interest on the 2008 $2,500 overpayment would be calculated using an *Original Due Date* of 10/15/09 and *Interest Thru* date of 6/1/11, the IL-870 issuance date. Since no subsequent payments are involved, refund interest only needs to be calculated in one segment, so $2,500 should be entered in the *Amount Due* field. The P&I Calculator for 2008 and the IL-870 would appear as below:



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Taxpayer Information

Taxpayer's name		Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/07	$5,000.00	$1,500.00	$1,131.78	$7,631.78
12/31/08	-$2,500.00	$0.00	-$77.33	-$2,577.33
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$2,500.00	$1,500.00	$1,054.45	$5,054.45

Remarks

Penalty and interest amounts for Y/E 12/31/07 reflect double rates for failure to participate in 2010 Amnesty Program.

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3. Audit Liabilities, Previously Assessed Penalty/Interest, Refund Previously Issued

Taxpayer timely filed its 2007 and 2008 calendar year IL-1120s on 10/15/08 and 10/15/09, respectively. For 2007 Taxpayer made 4 timely ES payments of $3,000 each. Its reported tax was $10,000, requesting a $2,000 refund. A refund for $2,031.72 ($31.72 interest) was issued on 9/1/09. For 2008 Taxpayer made no ES payments or timely IL-505-B extension payment for its reported $12,000 tax. It paid $13,305.53 on 10/15/09 with its IL-1120, correctly assessing a ES Late Pay penalty of $1,000, a late-payment penalty of $200, and interest of $105.53. An audit is conducted which increases the 2007 correct tax to $15,000 (creating an audit liability of $5,000), and the 2008 correct tax is increased to $15,000 (creating an audit liability of $3,000).

Since a refund in 2007 was issued, this refund and pertinent information should be entered in the *Amount Refunded* field detail screen, along with all the other payments and tax. The calculator will compute additional penalty and interest based upon the "reclaimed refund", which is the refund that was issued in error due to the subsequent liability established in audit. The *Amnesty Denied?* box should be checked to double the penalty and interest calculated for failure to participate in Amnesty on the unpaid tax. However, late-payment penalty should be manually calculated, since the refund interest of $31.72 is incorrectly treated as tax subject to late-payment penalty. Manually calculate the late-payment penalty of 15% x $5,000, and then double it for Amnesty. Secondly, to reclaim the $31.72 that was refunded originally to the taxpayer, this amount should be added to the interest calculated ($946.25), because otherwise this amount will not be collected from the taxpayer. In Amnesty situations, the reclaimed refund interest should not be subject to Amnesty penalty and added back after interest is doubled.

For 2008, the penalty and interest calculations become more complicated. Taxpayer was originally assessed and paid the $1,000 ES Late Pay penalty, $200 late-payment penalty, and $105.53 in interest. The calculator will compute penalties that include the originally assessed penalties. Only the interest and penalties associated with the liability should be put on the IL-870. In this example you should simply calculate the late-payment penalty on the audit liability and double it for Amnesty ($3,000 x 15% x 2). Calculating interest for 2008 is difficult because there was interest assessed and a payment made prior to the Amnesty period. Since the calculator does not recognize paid tax prior to or during Amnesty, it will only calculate single interest on the entire liability, or double that amount if the *Amnesty Denied?* box is checked. Therefore, the only way to calculate the correct interest to be shown on the IL-870 is to calculate interest on the separate liability amounts that accrue single and double interest.

The correct 2008 tax is $15,000. Single interest will accrue on $13,305.53 from 3/15/09 to 10/15/09 (the date it was paid), because that portion of the tax was paid before Amnesty. However, double interest will accrue on $1,694.47 ($15,000-$13,305.53) from 3/15/09 through 6/1/11 because that is the portion of tax unpaid by the end of Amnesty. By entering each of those amounts in the *Amount Due* field with the

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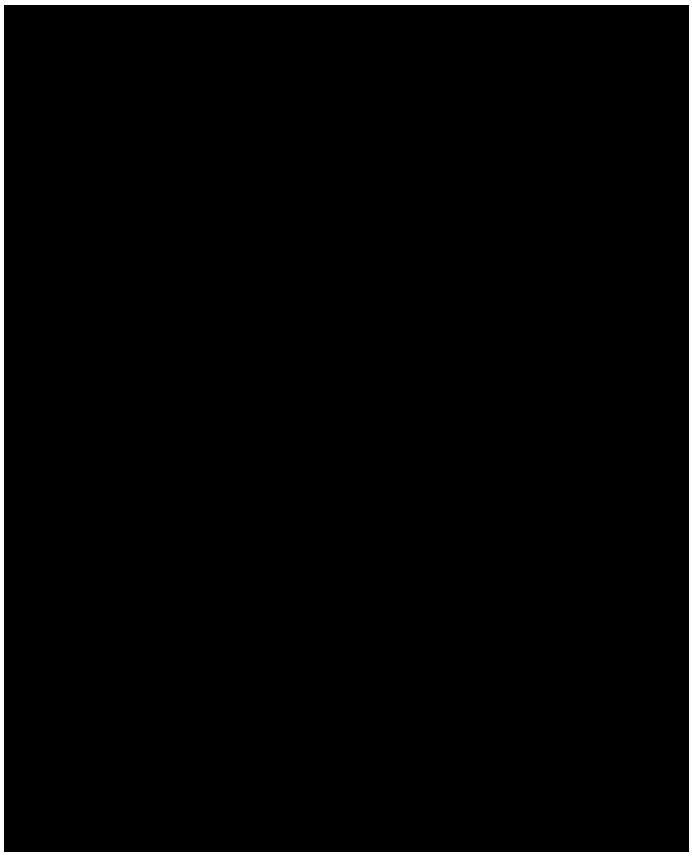
respective *Original Due Date* and *Interest Thru* dates (without entering any payments), you should calculate $117.01 in single interest on $13,305.53 and $194.23 ($97.12 x 2) of double interest on $1,694.47. Then you should add those two amounts, and subtract the $105.53 that was previously assessed to arrive at $205.71 in interest to show on the IL-870 for 2008. Shown below are the screenshots for the P&I Calculator and the IL-870:



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Taxpayer Information

Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/07	$5,000.00	$1,500.00	$977.97	$7,477.97
12/31/08	$3,000.00	$900.00	$205.71	$4,105.71
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$8,000.00	$2,400.00	$1,183.68	$11,583.68

Remarks

Penalty and interest amounts reflect double rates for failure to participate in 2010 Amnesty.

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Note:

2007 Interest = $946.25 + $31.72= $977.97

2008 Interest = $311.24 ($117.01 + $194.23) - $105.53 (originally assessed for 2008) = $205.71

2008 Penalty manually calculated: ($3,000 x .15) x 2 = $900

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4. Erroneous Refund/Reclaimed Refund Interest

Taxpayer timely filed its 2010 calendar year IL-1120 on 10/15/2011 reporting tax of $300,000. Taxpayer made 4 timely ES payments of $100,000 each, requesting a refund of $100,000. A refund for $100,210.98 ($210.98 interest) was issued on 6/1/2012. An audit is conducted which increases the correct tax to $375,000 (creating an audit liability of $75,000). The IL-870 issuance date is 3/1/2014.

Taxpayer will owe the $75,000 audit liability with interest and late-payment penalty, in addition to any reclaimed refund interest, with interest.

Taxpayer was erroneously refunded $100,000 and applicable interest of $210.98 due to the subseqent increase in tax during audit. Taxpayer should have only received a $25,000 refund and applicable interest. The overpayment interest on the correct refund amount of $25,000 will need to be calculated (from the date of overpayment (10/15/2011) to the date of the refund (6/1/2012)). Interest on the $25,000 refund would have been $52.75. (The penalty section can be ignored in this calculation.)

The reclaimed refund interest amount would then be $158.23 ($210.98 - $52.75) which will need to be returned to the department with interest.

For GenTax to calculate the proper late-payment penalty, and interest on the late payment and reclaimed refund, the payments and refunds will need to be entered. When entering the Refund amount, the entire amount refunded, including interest, less any interest properly due the taxpayer should be entered in the *Rfn Amount* field ($100,210.98 – 52.75). For the late-payment penalty to properly calculate, the *Use Override Amount* will need to be checked and the balance updated to reflect the audit liability amount ($75,000). The late-payment penalty can also be computed manually.

Shown below are screenshots of the P&I Calculator and the IL-870:

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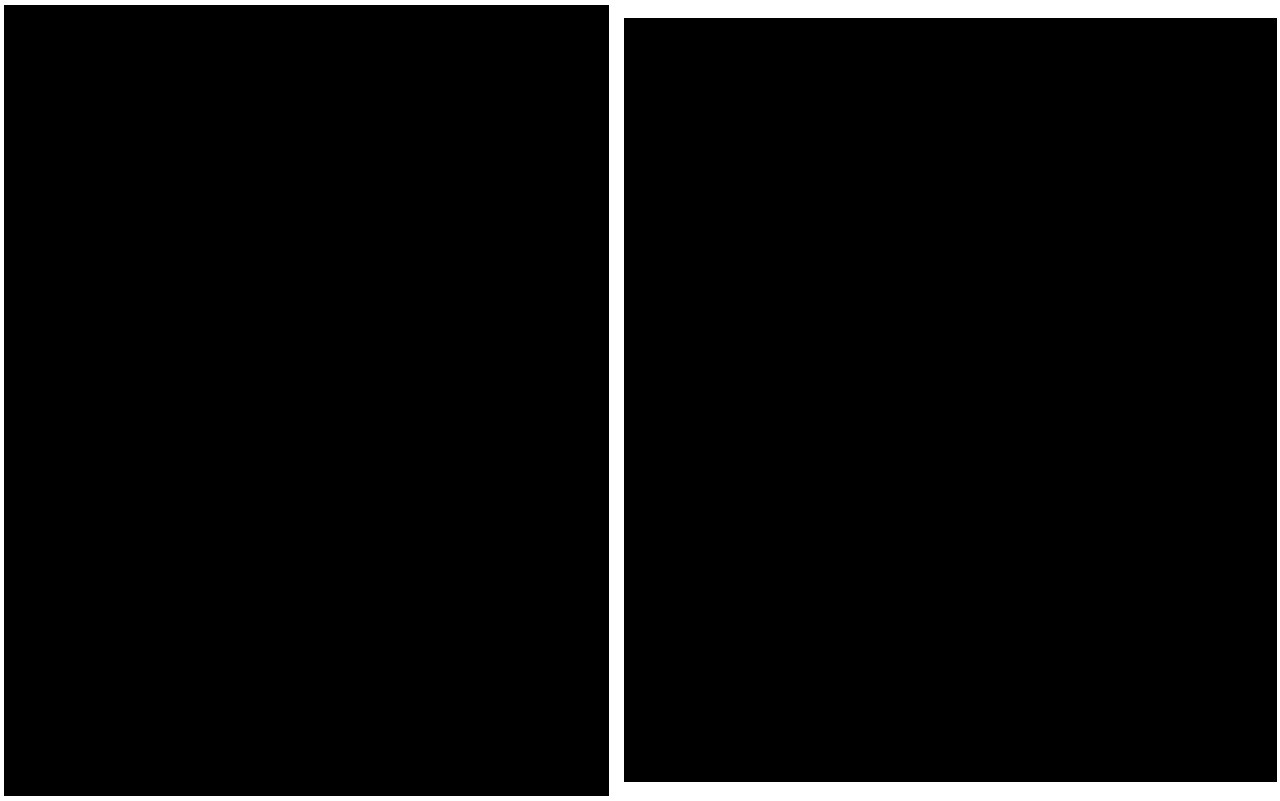

Taxpayer Information

Taxpayer name	Account ID	Audit ID

Increase or (Decrease) in Tax and Penalties

Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/2010	75,000.00	11,250.00	3,929.58	90,179.58
				0.00
				0.00
				0.00
				0.00
				0.00
Total	75,000.00	11,250.00	3,929.58	90,179.58

Remarks In addition to the above liability, reclaimed refund interest ($158.23) and interest ($7.99) totaling $166.22 is also due which will result in a net liability of $90,345.80.

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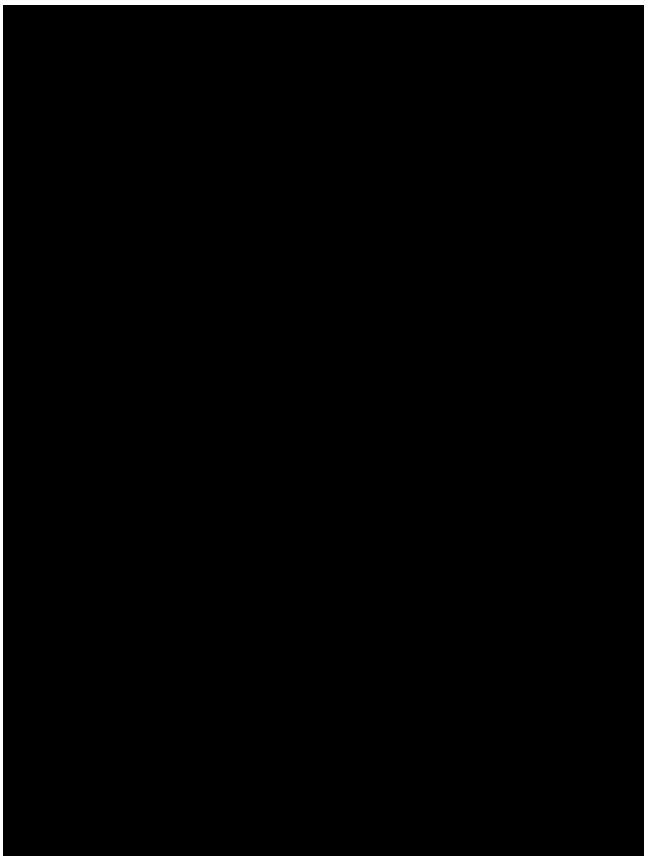
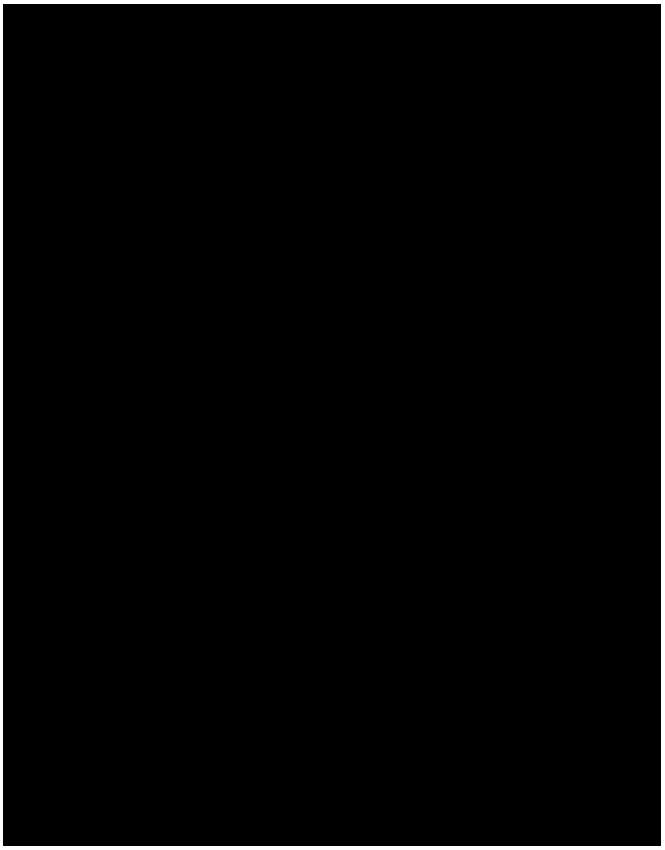
5. Audit Liabilities, Individual Non-Filer

An audit is being conducted for an individual for the calendar years 2007 and 2008. For 2007, Taxpayer was a nonfiler. The auditor determines that taxpayer should have reported a tax of $2,000 before applying withholding of $1,600. The total withholding should be divided into 4 parts and entered as timely ES payments. This leaves an audit liability of $400. Although no ES Late Pay penalty will be assessed because the correct tax due was less than $500, late-payment and late-file penalties will apply and be doubled for Amnesty. For 2008, Taxpayer did file a timely IL-1040 return on 4/15/09 reporting a tax of $2,500 before applying $2,000 in withholding. A timely IL-505-I extension payment of $500 was also made on 4/15/09. The auditor disallowed a Schedule CR credit claimed for $800, creating an audit liability. The IL-870 issuance date is 6/1/11. Penalty and interest will be doubled for Amnesty. Shown below are the screenshots for the P&I Calculator and the IL-870:





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Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/07	$400.00	$136.00	$85.79	$621.79
12/31/08	$800.00	$240.00	$84.91	$1,124.91
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$1,200.00	$376.00	$170.70	$1,746.70

Remarks

Penalty and interest amounts reflect double rates for failure to participate in 2010 Amnesty Program.

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6. Audit Liabilities, RAR, Net Overpayment:

Taxpayer timely filed its 2006 and 2007 calendar year IL-1120s on 10/15/07 and 10/15/08, respectively. For 2006, Taxpayer made 4 timely ES payments of $2,500 totaling $10,000 and a timely IL-505-B extension payment of $1,500, paying its $11,500 reported tax. For 2007 Taxpayer made 4 timely ES payments of $3,000 totaling $12,000 and a timely IL-505-B extension payment of $2,000, paying its reported tax of $14,000. Therefore, its return liabilities were timely paid and no penalties or interest were assessed. In 2010 an audit was initiated and continued through 2011. Taxpayer provided the auditor with a signed 2007 IL-1120-X on 2/1/11 for a claim of $8,000, reflecting an unreported RAR finalized in January 2011 with a reduction in federal taxable income. The audit established liabilities of $3,000 for tax year 2006 and $1,000 for 2007. For 2006 and 2007 the auditor will only list the proposed liabilities of $3,000 and $1,000 on the IL-870. The net total liability or refund should be stated in the Remarks section of the IL-870 form due to the RAR claim amount allowed. Taxpayer did not participate in Amnesty, and the issuance date for the IL-870 is 6/1/11. Therefore, double penalty and interest will be calculated through 6/1/11 on $3,000 for 2006. However, for 2007, after taking into account the RAR claim, Taxpayer has a net overpayment of $7,000, so no penalty and underpayment interest should be proposed in 2007. The auditor must also calculate the claim interest on $7,000 from 10/15/08 through 6/1/11. The total 2007 RAR claim will be netted against the IL-870 liability and the total liability or claim explained in the Remarks section. Shown below are the screenshots of the P&I Calculator and the IL-870:

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Taxpayer Information

Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/06	$3,000.00	$900.00	$1,147.58	$5,047.58
12/31/07	$1,000.00	$0.00	$0.00	$1,000.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$4,000.00	$900.00	$1,147.58	$6,047.58

Remarks

Penalty and interest amounts reflect double rates for failure to participate in 2010 Amnesty Program. Execution of this form will allow the approved claim filed on 2/1/11 for Y/E 12/31/07, in the amount of $8,000 (plus $545.99 applicable interest), to be used to offset the above-proposed liability which will result in a net overpayment of $2,498.41.

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7. Audit Claim, Participated in 2010 Amnesty:

Taxpayer's income tax return for the calendar year 2005 is under audit during the Amnesty Program Period, but no Established Liability has been created. Taxpayer participates in the Amnesty Program for 2005. After the audit is concluded, the Department determines that Taxpayer has overpaid its 2005 liability by $300. Taxpayer may receive a refund of any payments it made, because only payments of Established Liabilities are subject to limitations on refunds, but no interest is payable by the Department on any refund or credit allowed for a tax and period for which the taxpayer participated in the Amnesty Program (UPIA Section 3-2(h)). However, interest will be allowed on any refund or credit based on a refund claim that was outstanding as of the beginning of the Amnesty Program Period, per Amnesty Rules IAC §520.105(c)(5). Assuming the 2005 return was timely paid and filed on 10/15/06 and the IL-870 was to be issued on 6/1/11, the IL-870 would be presented as follows:

Taxpayer Information

Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/05	-$300.00	$0.00	$0.00	-$300.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	-$300.00	$0.00	$0.00	-$300.00

Remarks

No interest is payable by the Department on any refund or credit allowed for a tax and period for which the taxpayer participated in the 2010 Amnesty Program.

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8. Audit Liability and Audit Claim, Participated in 2010 Amnesty, Net Liability

Taxpayer timely filed its 2007 and 2008 calendar year IL-1120s on 10/15/08 and 10/15/09, respectively. The originally filed 2007 tax of $10,000 was paid by four timely ES payments of $2,250 each, and a timely $1,000 IL-505-B extension payment. The originally filed 2008 tax of $12,000 was paid by four timely ES payments of $2,700 each, and a timely IL-505-B extension payment of $1,200. In 2010 an audit was initiated and not going to be completed by the end of the Amnesty Program. The taxpayer filed IL-1120-Xs and made estimated Amnesty payments for both years on 11/08/10 of $7,500 each. The audit was completed in May, 2011 and established an additional $5,000 audit liability for tax year 2007 and a claim of $2,500 for 2008. Taxpayer agrees to audit results. No interest will be allowed on the audit claim. The issuance date for the IL-870 is 6/1/11. In this scenario, only the audit liability should be entered in the *Amount Due* without entering any payments for 2007. This is because the P&I Calculator will incorrectly calculate penalty and interest on amounts paid during Amnesty. To avoid incorrect penalty and interest, the liability interest should be calculated as in refund situations. In the Remarks section Taxpayer should be advised about the loss of Amnesty benefits for 2007 if the audit liability is not paid within 30 days of the IL-870 issuance date. Shown below are screenshots of the P&I Calculator for 2007 and the IL-870:

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Taxpayer Information

Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/07	$5,000.00	$1,500.00	$1,131.78	$7,631.78
12/31/08	-$2,500.00	$0.00	$0.00	-$2,500.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$2,500.00	$1,500.00	$1,131.78	$5,131.78

Remarks

Penalty and interest amounts for Y/E 12/31/07 reflect double rates for failure to participate in 2010 Amnesty Program. Failure to pay the total liability within 30 days of the issuance date of this form will lead to revocation of amnesty benefits previously allowed for Y/E 12/31/07 and additional penalty and interest will be assessed.

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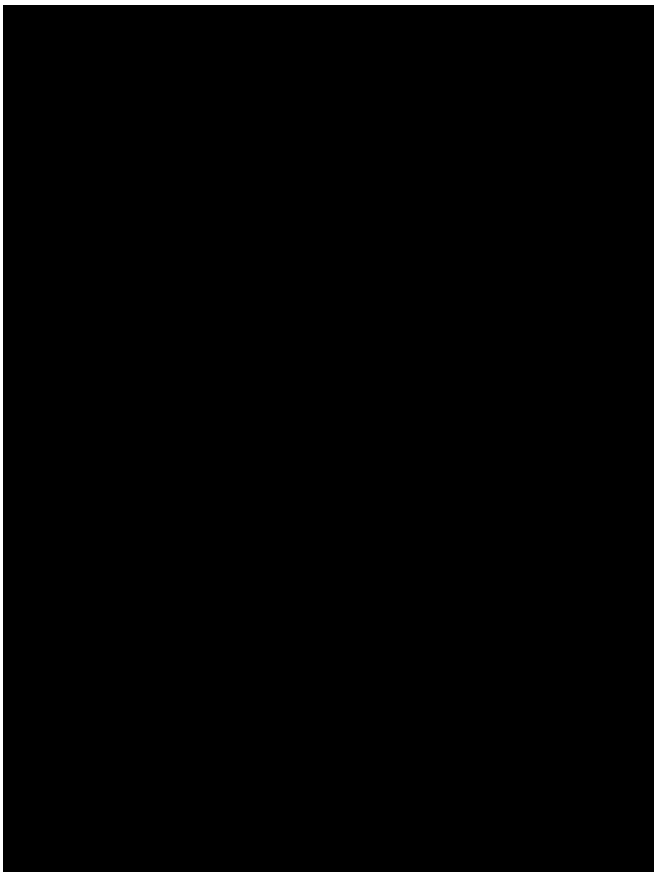
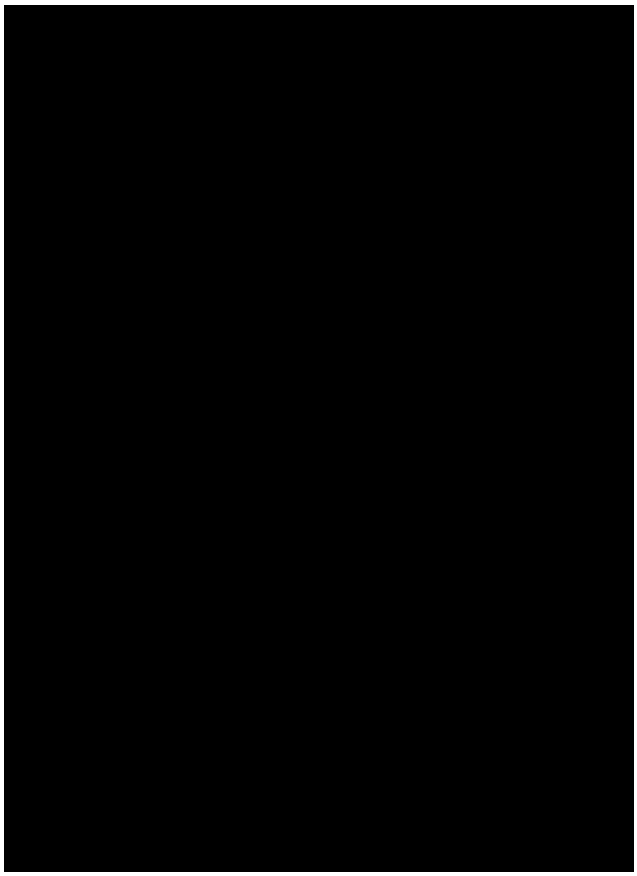
9. Audit Liabilities, RAR:

In 2011 Taxpayer is being audited for calendar years 2007 and 2008. Taxpayer timely filed its 2007 and 2008 calendar year IL-1120s on 10/15/08 and 10/15/09, respectively. The originally filed 2007 tax of $10,000 was paid by four timely ES payments of $2,250 each, and a timely $1,000 IL-505-B liability payment. The originally filed 2008 tax of $12,000 was paid by four timely ES payments of $2,700 each, and a timely liability payment of $1,200. Taxpayer did not participate in Amnesty. Taxpayer provides the auditor a signed 2007 IL-1120-X on 4/1/11 for an unreported RAR finalized on 3/15/2011, which increased federal taxable income and its Illinois tax liability by $5,000. No audit adjustment is found for 2007, and the auditor determines an audit liability of $3,000 for 2008. The net total liability or refund should be stated in the Remarks section of the IL-870 form due to the RAR liability. Since the 2007 RAR liability is a federal change finalized after Amnesty, only single interest should be assessed for not participating in Amnesty. Double penalty and interest would be assessed on the 2008 audit liability. The IL-870 issuance date is 8/1/11. Shown below are the screenshots of the P&I Calculator and the IL-870:





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Taxpayer Information

Taxpayer name	Account ID	Audit ID

Increase or (Decrease) in Tax and Penalties

Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/2007	0.00	0.00	0.00	0.00
12/31/2008	3,000.00	900.00	379.23	4,279.23
				0.00
				0.00
				0.00
				0.00
Total	3,000.00	900.00	379.23	3,900.00

Remarks Penalty and interest amounts for Y/E 12/31/08 reflect double rates for failure to participate in 2010 Amnesty Program. In addition to above liability, tax ($5,000), penalty ($750) and interest ($595.34) totaling $6,345.34 is also due from the amended return filed on 4/1/11 for the Y/E 12/31/07, which will result in a net liability of $10,624.57 being due.

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10. Audit Liabilities, RAR, Participated in 2010 Amnesty:

In 2011 Taxpayer is being audited for calendar years 2007 and 2008. Taxpayer timely filed its 2007 and 2008 calendar year IL-1120s on 10/15/08 and 10/15/09, respectively. The originally filed 2007 tax of $10,000 was paid by four timely ES payments of $2,250 each, and a timely $1,000 IL-505-B extension payment. The originally filed 2008 tax of $12,000 was paid by four timely ES payments of $2,700 each, and a timely liability payment of $1,200.

Taxpayer participated in Amnesty by filing IL-1120-Xs and paying its 2007 and 2008 eligible liabilities (representing the estimated adjustments that could be made in audit) of $10,000 and $12,500, respectively, on 11/8/10. These were not Estimated Federal Change Liabilities. Taxpayer provides the auditor with a signed 2007 amended return on 4/30/11 to report an unreported RAR finalized on 3/15/11, which increased federal taxable income and its Illinois tax liability by $5,000. No audit adjustments are found for the amounts reported on the amended returns for 2007.

Since the liability on the second amended 2007 return is due to a federal change finalized after Amnesty, only single interest should be assessed for not participating in Amnesty, as long as the taxpayer timely pays the assessed 2007 liability within 30 days of the IL-870 issuance date. The net total liability or refund should be stated in the Remarks section of the IL-870 due to the RAR liability.

The auditor determines an additional audit liability of $3,000 for 2008 (total tax due is $27,500). Double penalty and interest would be assessed on the 2008 additional audit liability.

In this scenario (similar to 8), only the audit liabilities should be entered in the *Amount Due* without entering any payments for 2007 or 2008. This is because the P&I Calculator will incorrectly calculate penalty and interest on amounts paid during Amnesty. To avoid incorrect penalty and interest, the liability interest should be calculated as in refund situations.

If the taxpayer fails to pay the assessed liability within 30 days of the IL-870 issuance date, the taxpayer will forfeit the Amnesty abated penalty and interest on the entire additional tax of $10,000 for 2007 and $15,500 for the 2008 tax year. The IL-870 issuance date is 8/1/11. Shown below are the screenshots for the P&I Calculator and the IL-870:

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Taxpayer Information

Taxpayer's name | Federal employer identification number or Social Security number | Track number

Increase or (Decrease) in Tax and Penalties

Tax Year Ending	Amount of Tax	Penalty	Interest	Total
12/31/2007	0.00	0.00	0.00	0.00
12/31/2008	3,000.00	900.00	379.23	4,279.23
Totals:	3,000.00	900.00	343.89	4,243.89

Remarks:

Penalty and interest amounts for Y/E 12/31/08 reflect double rates for failure to participate in 2010 Amnesty Program. In addition to above liability, tax ($5,000), penalty ($750) and interest ($595.34) totaling $6,345.34 is also due from the amended return filed on 4/30/11 for the Y/E 12/31/07, which will result in a net liability of $10,624.57 being due. Failure to pay the total liability within 30 days of the issuance date of this form will lead to revocation of amnesty benefits previously allowed for the above tax years and additional penalty and interest will be assessed.

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11. Audit Liability and Claim, RAR, Participated in 2010 Amnesty, Net Liability

In 2011 Taxpayer is being audited for calendar years 2007 and 2008. Taxpayer timely filed its 2007 and 2008 calendar year IL-1120s on 10/15/08 and 10/15/09, respectively. The originally filed 2007 tax of $10,000 was paid by four timely ES payments of $2,250 each, and a timely $1,000 liability payment. The originally filed 2008 tax of $12,000 was paid by four timely ES payments of $2,700 each, and a timely liability payment of $1,200. Taxpayer participated in Amnesty by filing IL-1120-Xs and paying its 2007 and 2008 eligible liabilities of $10,000 and $12,500, respectively, on 11/8/10. The 2007 liability was due to an RAR finalized prior to Amnesty. During the audit, an additional liability unrelated to the RAR of $5,000 is established for 2007 and a claim of $3,000 for 2008. The taxpayer is assessed double penalty and interest on the $5,000 audit liability, and no interest will be allowed on the $3,000 claim.

In this scenario (similar to 8), only the audit liability should be entered in the *Amount Due* without entering any payments for 2007. This is because the P&I Calculator will incorrectly calculate penalty and interest on amounts paid during Amnesty. To avoid incorrect penalty and interest, the liability interest should be calculated as in refund situations.

If Taxpayer fails to pay the IL-870 within 30 days of the issuance date, then Amnesty abatement for 2007 would be forfeited and assessed at the double rate because the payment was related to a federal change finalized prior to the end of Amnesty. The IL-870 issuance date is 6/1/11. Shown below are the screenshots for the P&I Calculator and the IL-870:

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[redacted]

Taxpayer information

Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/07	$5,000.00	$1,500.00	$1,131.78	$7,631.78
12/31/08	-$3,000.00	$0.00	$0.00	-$3,000.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$2,000.00	$1,500.00	$1,131.78	$4,631.78

Remarks

Penalty and interest amounts for Y/E 12/31/07 reflect double rates for failure to participate in 2010 Amnesty Program. No interest is payable by the Department on any refund or credit for a tax and period in which the taxpayer participated in 2010 Amnesty Program. Failure to pay the total liability within 30 days of the issuance date of this form will lead to revocation of amnesty benefits previously allowed for Y/E 12/31/07 and additional penalty and interest will be assessed.

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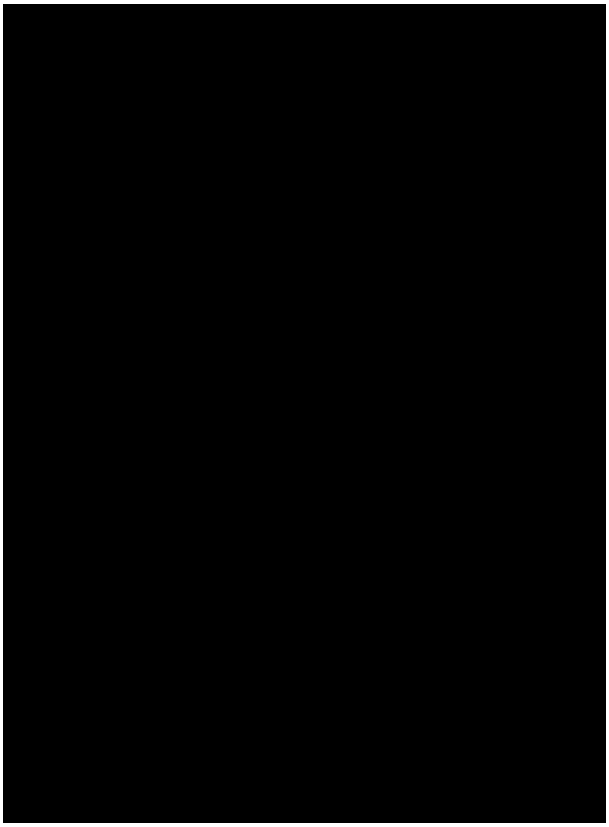
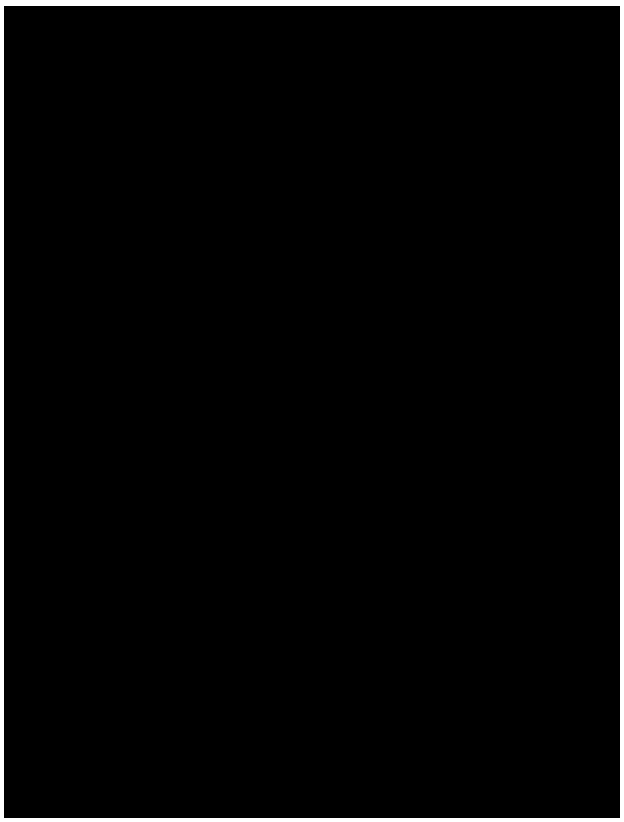
12. Audit Liabilities and Claim, RAR/Capital Loss, Net Liability:

In 2011 Taxpayer is being audited for calendar years 2007 and 2008. Taxpayer timely filed its 2007 and 2008 calendar year IL-1120s on 10/15/08 and 10/15/09, respectively. Its originally filed 2007 tax of $10,000 was paid by four timely ES payments of $2,250 each, and a timely $1,000 liability payment. Its originally filed 2008 tax of $12,000 was paid by four timely ES payments of $2,700 each, and a timely liability payment of $1,200. Taxpayer did not participate in Amnesty. On 4/30/11 Taxpayer presents the auditor with a signed 2004 IL-1120-X for an unreported RAR finalized on 3/15/11. The adjustment was for an increase in capital losses in 2007, which carried back to 2004 creating an Illinois claim for $3,000. The audit is expanded to include 2004 and no additional adjustment is found in that year to reduce the claim. Audit liabilities of $5,000 and $10,000 are determined for years 2007 and 2008. According to IAC §100.9400(c)(3)(C), interest on the 2004 overpayment due to the federal capital loss carryback is calculated from the date of claim, which would be the processable date for the 2004 IL-1120-X. Since the 2004 overpayment is due to a federal capital loss carryback and will be offset within 3 months of the claim date, then no refund interest should be accrued (IAC §100.9400(c)(3)(C)). Double penalty and interest would be calculated through the IL-870 issuance date for the audit liabilities. The net total liability or refund should be stated in the Remarks section of the IL-870 form due to the RAR overpayment. The IL-870 issuance date is 6/1/11. Shown below are the screenshots of the P&I Calculator and the IL-870:





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Taxpayer Information

Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/04	$0.00	$0.00	$0.00	$0.00
12/31/07	$5,000.00	$1,500.00	$1,131.78	$7,631.78
12/31/08	$10,000.00	$3,000.00	$1,146.30	$14,146.30
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$15,000.00	$4,500.00	$2,278.08	$21,778.08

Remarks

Penalty and interest amounts for Y/E 12/31/07 and 12/31/08 reflect double rates for failure to participate in 2010 Amnesty Program. Execution of the form will allow approved claim filed on 4/1/11 for Y/E 12/31/04, in the amount of $3,000, to be used to offset the above proposed liability which will result in a net liability of $18,778.08 being due.

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13. Audit Liability, INOL Carryback, Restricted Interest:

Taxpayer is being audited in 2011 for their calendar 2000, 2001, and 2002 years, which has been ongoing since 2004 and years have been kept in statute due to signed IL-872s. Taxpayer timely filed and paid liabilities for original 2000 and 2001 returns, and reported a net loss for 2002. The 2002 loss was carried back to 2000, reducing the 2000 liability to $10,000, and a refund was paid. The auditor increased the 2002 Illinois Net Operating Loss (INOL) and increased income in 2000, which resulted in additional tax due of $3,000. After the 2002 INOL is carried back, the 2000 audit liability will be zero. Taxpayer agrees to the audit results. The IL-870 issuance date is 6/1/11. Even though the Illinois Net Loss Deduction (INLD) for 2000 will reduce the audit liability to zero, interest must be calculated from the date the liability was originally due to the last day of the taxable year in which the loss was incurred. "Restricted interest" must be assessed on $3,000 from 3/15/01 through 12/31/02. By entering the $3,000 INLD as a payment with a date of 12/31/02, the calculator will correctly calculate interest from 3/16/01 through 12/31/02.

Also, since the penalty would be a UPIA-3 late-payment penalty, none will be assessed on the IL-870. The Remarks section must explain what Taxpayer's actual liability is. Shown below are the screenshots for the P&I Calculator and the IL-870:

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[redacted]

Taxpayer Information

Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/00	$3,000.00	$0.00	$365.01	$3,365.01
12/31/01	$0.00	$0.00	$0.00	$0.00
12/31/02	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$3,000.00	$0.00	$365.01	$3,365.01

Remarks

Execution of this form will allow approved Illinois Net Operating Loss for Y/E 12/31/02 to offset the above proposed liability, which will result in a net liability of $365.01 being due.

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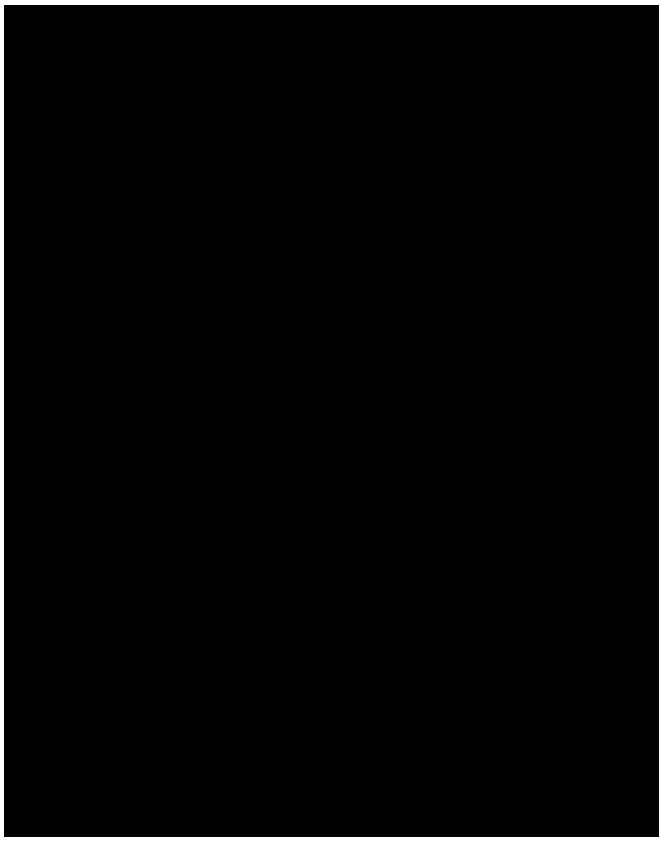
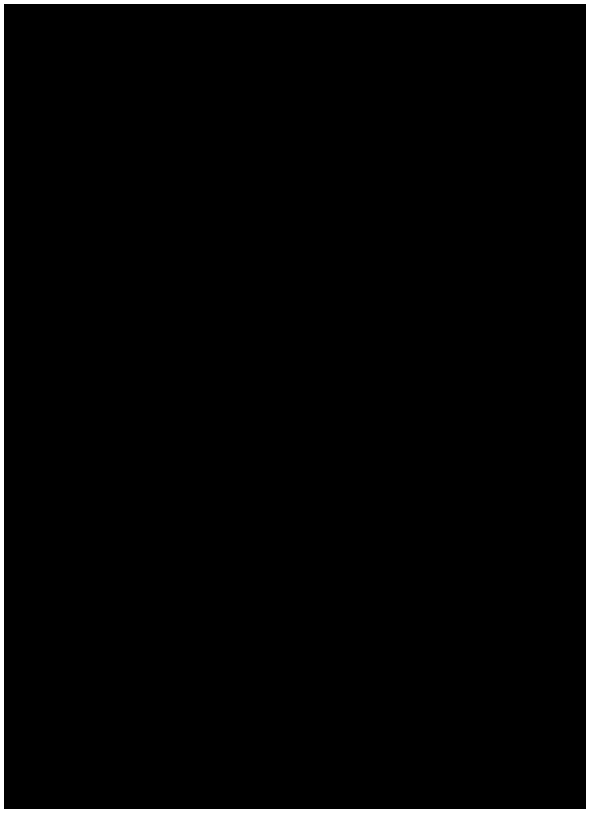
14. Audit Liability, INOL Carryback (Partial Offset), Restricted Interest:

Facts are the same as in Example 12, except that once the 2002 INOL is carried to 2000, a liability of $2,000 remains. Taxpayer agrees to the audit results. This will still leave an unpaid tax balance of $2,000 as of the IL-870 date of 6/1/11. First, since the penalty will be a UPIA-3 late-payment penalty, none will be assessed on the IL-870. Second, the interest must be calculated as two tiers on the $3,000 increase in 2000: first, "restricted interest" on $1,000 from 3/15/01 through 12/31/02; second, interest on $2,000 from 3/15/01 through the IL-870 date of 6/1/11. With all the previous payment and tax liability in the calculator for APE 12/00, by entering the 2000 INLD as a payment of $1,000 dated 12/31/02, the calculator will calculate restricted interest on $1,000 from 3/15/01 through 12/31/02, and interest on $2,000 from 3/15/01 to 6/1/11. This case is unique because all interest associated with the unpaid $2,000 tax must be doubled for failure to have been paid during 2003 Amnesty Program. Therefore, doing a second interest calculation on $2,000 from 3/15/01 to 6/1/11 and adding that to the first calculation will double the interest on $2,000. Enter $2,000 in *Amount Due* (without any payments) and calculate interest from 3/15/01 through 6/1/11, and manually add this interest amount ($1,158.86) to the interest from the first calculation ($1,280.53). (Note: The restricted interest is not doubled because there is no liability associated with this interest and therefore doubling for Amnesty does not apply.) Lastly, the actual taxpayer liability will have to be stated in the "Remarks" section. Shown below are the screenshots for the P&I Calculator and the IL-870:





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Taxpayer information

Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/00	$3,000.00	$0.00	$2,439.39	$5,439.39
12/31/01	$0.00	$0.00	$0.00	$0.00
12/31/02	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$3,000.00	$0.00	$2,439.39	$5,439.39

Remarks

Interest for Y/E 12/31/00 reflects double rate for failure to participate in 2003 Amnesty Program on the additional unpaid liability of $2,000. Execution of this form will allow approved Illinois Net Operating Loss for Y/E 12/31/02 to partially offset the above proposed liability, which will result in a net liability of $4,439.39 ($2,000 tax and $2,439.39 interest) being due.

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15. Audit Claim, Pending Refunds, Net Liability:

Taxpayer makes four equal estimated payments on their due dates for calendar year 2007 totaling $60,000. Taxpayer timely files year 2007 IL-1120 on 10/15/08. The tax reported was $50,000, and a $10,000 refund was requested and is pending. For calendar year 2008, Taxpayer made 4 equal estimated payments on the due dates totaling $80,000. The IL-1120 was timely filed on 10/15/09 reporting tax of $70,000; another $10,000 refund was requested and is pending. An audit was performed in 2011 on the above-mentioned tax years. No audit adjustments were found for 2007, and an audit liability of $25,000 was established for 2008. To calculate the total audit liability, each year's liability must be determined separately, and then offset to determine the final refund or liability. The IL-870 date is 6/1/11. In 2007, although there is no audit change, there is a pending refund. Therefore, you must calculate the appropriate accrued interest so that the total 2007 overpayment can be offset against the 2008 audit liability and either the net overpayment or liability be stated in the Remarks section. For the 2007 pending refund, the date of overpayment is the later of the due date or the date the return is filed, which is 10/15/08 and should be entered in the *Original Due Date* field. The *Interest Thru* date will be the IL-870 date of 6/1/11.

For 2008, the auditor must first look at what was timely paid and the tax required to be shown (tax originally filed modified by any audit adjustment). Secondly, any subsequent payments must be accounted for when determining interest. Taxpayer had paid $80,000 by the payment due date, had a pending refund of $10,000, and had an audit liability of $25,000. First, the penalty base should be determined by looking at the tax that was required to be shown on the return, reduced by any part of the tax which was paid on time and by any credit which was properly allowable on the date the return was required to be filed. The tax required to be shown was $95,000, and $80,000 was paid by the payment due date. Since the refund was pending and had not been issued, the penalty base is $15,000. To calculate audit liability interest, the *Original Due Date* entered is 3/15/09 and the *Interest Thru d*ate entered is 6/1/11. Both penalty and interest must be doubled for failure to participate in 2010 Amnesty. Then 2007 and 2008 can be offset and the total liability or refund explained in the Remarks section. Shown below are the screenshots for the P&I Calculator and the IL-870:

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Taxpayer information

Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/07	$0.00	$0.00	$0.00	$0.00
12/31/08	$25,000.00	$4,500.00	$1,719.46	$31,219.46
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$25,000.00	$4,500.00	$1,719.46	$31,219.46

Remarks

Penalty and interest amounts for Y/E 12/31/08 reflect double rates for failure to participate in 2010 Amnesty Program. Execution of this form will allow pending refunds for Y/E 12/31/07 in the amount of $10,780 (includes interest of $780), and Y/E 12/31/08 in the amount of $10,000, to be offset against the above proposed liability, which will result in a net liability of $10,439.46 being due.

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16. Audit Liabilities, Previously Assessed Penalty/Interest, Pending Refund, Net Overpayment:

In 2011 Taxpayer is being audited for calendar years 2007 and 2008. Taxpayer made no ES payments and one timely 2007 IL-505-B extension payment on 3/15/08 of $60,000, and files calendar year 2007 IL-1120 on 10/15/08. The tax reported was $50,000 and was assessed a $4,500 ES Late Pay penalty, with a pending refund of $5,500. For 2008 Taxpayer made no timely estimated or extension payments. The IL-1120 was timely filed on 10/15/09 with a return payment for the tax reported of $70,000. Taxpayer was assessed a ES Late Pay penalty of $5,000, a late-payment penalty of $2,000, and interest of $615.60. Taxpayer made a payment of $7,615.60 on 12/15/09 and had a zero balance.

An audit was performed in 2011 on both periods finding an audit liability of $1,000 for 2007 and $2,500 for 2008. Again, each year should be examined separately and then the results offset for determining the total audit refund or liability. The IL-870 date is 6/1/11. In 2007, although the IL-870 will show a $1,000 audit liability, Taxpayer actually has a net overpayment of $4,500, so there is no penalty base and refund interest will be calculated on $4,500 from 10/15/08 through the IL-870 date of 6/1/11.

For 2008 an audit liability of $2,500 is established. First, to determine the penalty base, the auditor must compare the correct tax required to the tax timely paid. The penalties calculated in this instance will be all penalties assessed on this account. However, the auditor should not propose the portion of penalty that was already assessed (and paid) on the IL-870. Also, using the *Include Audit Late Payment Penalty* checkbox without overriding the audit late-payment penalty base would incorrectly calculate the additional 5% on $70,000 of the tax base upon which Taxpayer has already been assessed. In this example (with previously assessed penalties), the safest approach is to manually calculate the penalty on the audit liability to be included on the IL-870. That would be 15% on $2,500. Since the correct tax was completely paid by 12/15/09, the penalty should not be doubled for Amnesty.

As in 3, calculating interest for 2008 is difficult because there was interest assessed and a payment made prior to the Amnesty period. Since the calculator does not recognize paid tax prior to or during Amnesty, it will only calculate single interest on the entire liability, or double that amount if the *Amnesty Denied?* box is checked. Therefore, the only way to calculate the correct interest to be shown on the IL-870 is to calculate interest on the separate liability amounts that accrue single and double interest. In this example, however, the correct tax after audit is $72,500, which is completely paid after the $7,615.60 payment on 12/15/09. Therefore, the interest should not be doubled for Amnesty. For the IL-870 2008 interest, the interest previously assessed (and paid) by the taxpayer must be manually subtracted from the total interest computed by the calculator through 6/1/11. The net result is $26.17 ($641.77-$615.60), which is the Interest associated with the 2008 audit liability. Then, the two years will be offset, and the total liability or refund will need to be explained in the Remarks section.
Shown below are the screenshots for the P&I Calculator and the IL-870:

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[redacted]

[redacted]

Taxpayer Information

Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/07	$1,000.00	$0.00	$0.00	$1,000.00
12/31/08	$2,500.00	$375.00	$26.17	$2,901.17
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$3,500.00	$375.00	$26.17	$3,901.17

Remarks

Execution of this form will allow pending refund for Y/E 12/07 in the amount of $5,850.99 (includes interest of $350.99) to be offset against the above proposed liability, which will result in a net overpayment of $1,949.82 being refunded.

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17. Audit Liability, Applied Credit Carryforward:

In 2011 Taxpayer is being audited for calendar years 2007 and 2008. Taxpayer timely filed its calendar 2007 IL-1120, having made 4 timely estimated payments of $500 each. The original tax shown was $1,500. Taxpayer requested that the $500 overpayment be applied as a credit carryforward ("CCF") to its 2008 tax liability. For tax year 2008, 3 timely estimated payments of $500 were made for the 2nd, 3rd, and 4th quarters. The 2008 IL-1120 was timely filed, and the original tax shown was $1,750. Taxpayer requested a $250 refund, which was issued in 2009. The auditor determines that there is an audit liability of $1,000 for 2007 and none for 2008. Taxpayer did not participate in the 2010 Amnesty Program. The auditor is going to issue the IL-870 on 6/1/11.

First, the penalty base is determined by checking what the tax required to be shown was less timely payments and credits. For UPIA 5, any credits or refunds allowed are not considered timely paid for late-payment penalty. Since the CCF was applied to the following year, the 2007 penalty base would be $1,000 [$2,500 tax – ($2,000 ES - $500 CCF allowed)]. A UPIA 5 late-payment penalty of 15% will be assessed and doubled for the Amnesty rate.

Next, interest must be calculated for 2007. Although the audit liability is $1,000, Taxpayer had a $500 CCF that was applied to the 2008 year. That CCF was applied to 2008 on the dates needed to satisfy the estimated payment requirements. In this example, the quarterly required 2008 ES payments were $393.75 (($1,750 x 90%)/4). The $500 CCF would have been applied as of the dates needed for the required ES payments. Therefore, $393.75 was applied on 4/15/08, and the remainder ($106.25) was applied to the second quarter payment due on 6/15/08. Interest should only be accrued on the CCF on the dates it was needed. Taxpayer's $500 CCF was applied on 4/15/08 and 6/15/08, so 6/15/08 is the date that the full $1,000 audit liability would be charged interest (because Taxpayer was only underpaid $500 until the additional $500 credit was fully applied). In other words, three tiers of interest must be calculated:

- $500 from 3/15/08 through 6/1/11
- $393.75 from 4/15/08 through 6/1/11
- $106.25 from 6/15/08 through 6/1/11

This can be accomplished with the P&I Calculator by entering all the appropriate payment and tax information, and then entering the 2008 CCF amounts in the *Amount Refunded* detail screen. Only the *Rfn Issued* dates (4/15/08 and 6/15/08) and the *Rfn Amount* ($393.75 and $106.25) should be entered. Do not enter a date in the *Return Rcvd Date* field in this situation, since no refund interest was involved and the credit carryforward is applied before the date the 2007 return was filed. Now the calculator will correctly calculate interest on the three tiers needed. Interest would also be doubled for failure to participate in 2010 Amnesty. Since there is no 2008 audit liability and the refund has been issued, no additional calculations need to be done for 2008.

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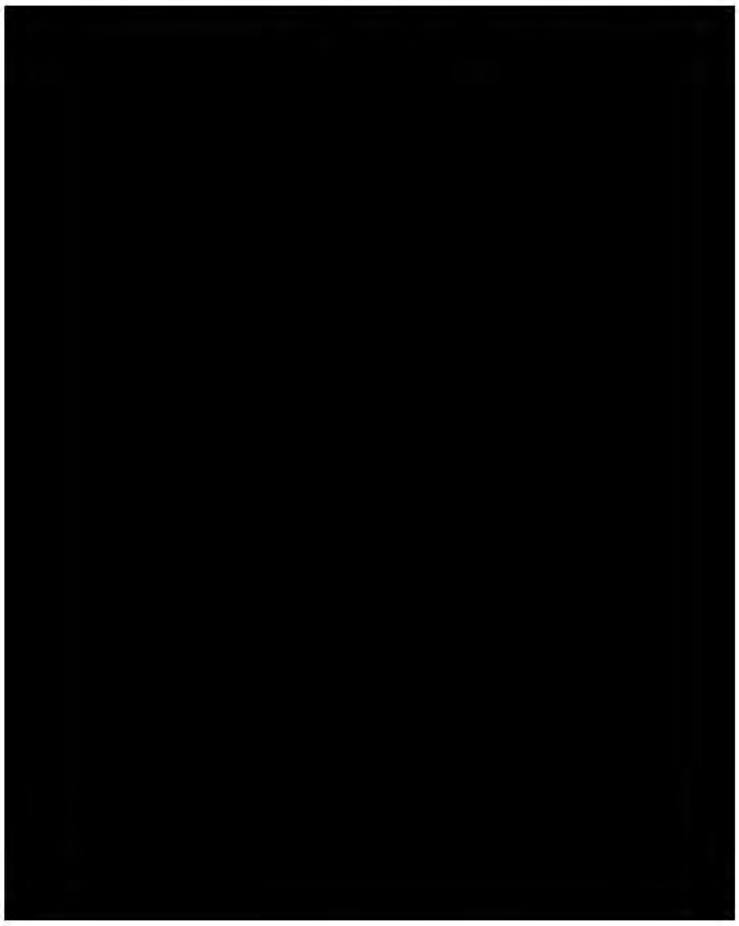
Shown below are the screenshots for the P&I Calculator and the IL-870:



Taxpayer Information

Taxpayer's name	Federal employer identification number or Social Security number	Track number

Increase (or Decrease) in Tax and Penalties

Tax Year Ended	Amount of Tax	Penalty	Interest	Total
12/31/07	$1,000.00	$300.00	$221.54	$1,521.54
12/31/08	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
	$0.00	$0.00	$0.00	$0.00
Totals:	$1,000.00	$300.00	$221.54	$1,521.54

Remarks

Penalty and interest amounts for Y/E 12/31/07 reflect double rates for failure to participate in 2010 Amnesty Program.

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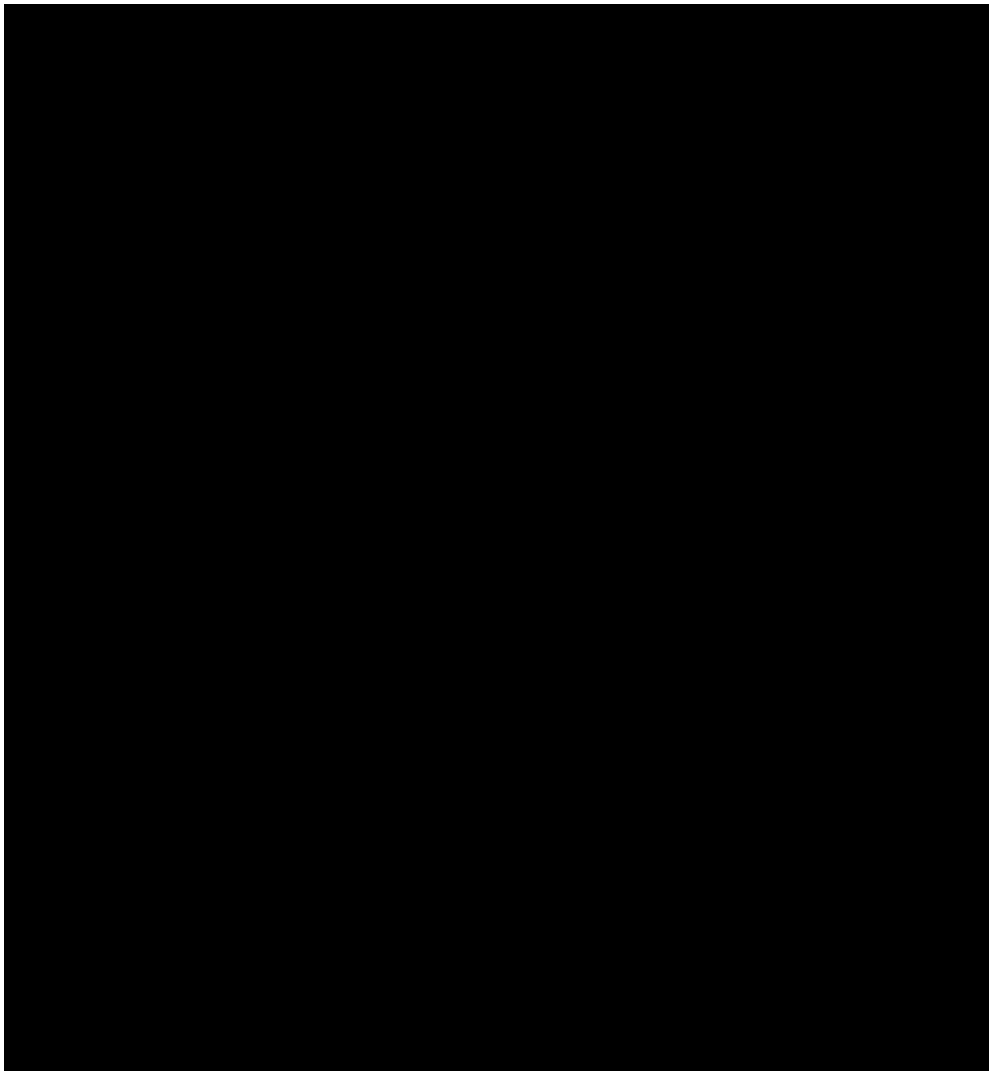
18. Audit Liability, Credit Carryforwards, Refund Previously Issued, Amnesty

This is an example of an actual audit situation and the resulting penalty and interest assessment, which an auditor is likely to encounter.

Taxpayer has a fiscal year end of 3/31/2008 and timely filed its 2008 IL-1120 on 11/16/2008. For 2008 taxpayer made two estimated payments ($2,304,000 on 9/9/2007 and $1,081,000 on 6/8/2008). There was a credit carryforward of $4,418,269.76 from 2007 applied on 6/15/2007. The reported tax was $951,146. A refund for $3,666,751.59 ($359,270 interest) was issued on 5/31/2012. An audit was conducted in 2013 which increased the 2008 correct tax to $4,878,392 (creating an audit liability of $3,927,246). Penalties and Interest will be doubled for Amnesty.

Below is the transaction history for the taxpayer shown on GenTax:



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[redacted]

Determining Late-Payment Penalty Basis ((3-3(b-20)(2) & (3-3(c)):

4,878,392.00	Tax required to be shown on a return, reduced by any
(3,385,000.00)	Tax paid on time, and
(4,418,269.76)	Credits propertly allowable on the date the return was required to be filed
3,227,980.76	Add back overpayments on original return allowed as a refund or credit
303,103.00	Penalty Basis

GenTax input:

On the Main Tab of the P&I Calculator enter the *Original Due Date*, the *Amount Due,* and *Interest Thru*, check *Include Audit Late Payment Penalty* box and *Amnesty Denied?* Box

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On the Payment/Refund Tab of the P&I Calculator enter the credits and estimated payments under Amount Paid. The total of these amounts is reflected as the *Amount Paid* on the Main screen.

Under Refund enter the credit carryforward and credit transfer out amounts. Also, enter the tax (principal) refunded and the improper amount of refund interest that the taxpayer

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owes the Department, both under *Rfn Amount*. The total of these amounts is reflected as the *Amount Refunded* on the Main Screen.

The following screens show the penalty calculations based on the information entered on the prior screens and additional modifications to the individual screens.

Late File Calculation

(Check *Use Extended Due Date* and enter the *Extended Due Date*. This will eliminate the Late File penalty from the Main screen.)

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Late Pay Calculation

(Check *Use Override Amount* and enter the correct penalty base in the *Balance* column for the appropriate tiers.)

[redacted]

ES Late Pay Calculation

(The auditor was not concerned with any estimated late payment penalties, so the estimated payments were not entered on this screen to compute the penalty)

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[redacted]

Audit Late Payment Penalty

(Check *Override Amount Indicator* and enter the correct penalty base in the *Balance* column for the appropriate tiers.)

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The *Total Interest* calculated, $352,994.43 (the amounts above need to be doubled for Amnesty), reflects interest from 1/15/2009, which is the date on which the account became underpaid due to the credit transfer ($754,725), on the basis of $303,103. The interest basis increased on 5/31/2012 due to the refunds of overpayments of tax ($3,307,481.59) and the associated interest ($359,270). Interest is being calculated through 8/5/2013, the date of the IL-870.

The Total Interest calculated needs to be increased by the interest on erroneous refunds ($359,270) so that those funds are returned, or "reclaimed", by the Department. This interest is often referred to internally as "reclaimed refund interest". It is interest that the taxpayer should never have received based upon the corrected tax. Including the reclaimed refund interest increases the final *Total Interest* to $712,264.43.

The proposed amounts on the IL-870 would be:

	Increase in Tax and Penalties			
Year ended	Amount of Tax	Penalty	Interest	Total
03/31/2008	$3,927,246	$90,931	$712,264	$4,730,441
TOTAL:	$3,927,246	$90,931	$712,264	$4,730,441

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The above examples are only illustrative of some of the situations that auditors will encounter. Many will simply require calculating interest on the corrected audit tax from the original due date of the return, or refund interest from the later of the filing date of the original return or its original due date, to the IL-870 issuance date. However, care must be taken to account for offsets, original overpayments, previously assessed penalties and interest, subsequent payments, Amnesty years, credits and refunds, RARs, and restricted interest. The examples in this chapter and Publication 103 are a good starting point for explaining more complicated situations, such as restricted interest. Audits involving more complex penalty and interest calculations should be discussed with supervisors and Technical Support to prevent issuing erroneous IL-870s. Lastly, the P&I Calculator can also be useful for providing the taxpayer with penalty and interest projections based upon different refund/liability scenarios.

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19. Late ES Payment Penalty Examples

a) 3-3(b-20)(1)

Corporation P timely files its IL-1120 for the tax year ending December 31, 2010 on March 15, 2011. The income tax liability shown on the return was $260,000. The taxpayer had only made estimated payments totaling $195,000 (including a credit carryforward from 2009 of $15,000); $65,000 tax was paid with the original return. Tax shown on the 2009 return was $300,000.

Estimated payments made for 2010 were as follows:

Credit carryforward from 2009	$15,000
April 15, 2010	40,000
June 15, 2010	60,000
September 15, 2010	40,000
December 15, 2010	40,000
Total estimated payments	$195,000

The Late ES Payment penalty would be calculated in GenTax as follows:

Main Screen:

[redacted]

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Payment/Refund Screen:

[redacted]

Penalty Screen/ES Late Pay Calculation:

[redacted]

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(1) IL-2220 Computation of Penalties for Businesses

The Late ES Payment penalty for this same example would be calculated on the IL-2220 as follows:

Step 2: Figure your required installments - Form IL-1120 filers only

		A This year	B Last year
5	Write the total **net** income and replacement tax from Form IL-1120. See instructions. If prior year's tax was zero or you filed a short year return, write "N/A" in Column B.	5 260,000.00	300,000.00
6	Multiply Column A, Line 5, by 90% (.9).	6 234,000.00	
7	If Column A, Line 5, is $400 or less, write "0" and go to Step 3. Otherwise, write the **lesser** of Column A, Line 6, or Column B, Line 5. See instructions.	7 234,000.00	
8	Divide the amount on Line 7 by four. This is the amount of each required installment. (*If you used the annualized income installment method, see instructions.*)	8 58,500.00	

		Quarter 1	Quarter 2	Quarter 3	Quarter 4
9	Write in Quarters 1 through 4, the installment date that corresponds with the 15th day of the 4th, 6th, 9th, and 12th month of your tax year.	9 04 / 15 / 2007	06 / 15 / 2007	09 / 15 / 2007	12 / 15 / 2007
10	Write the required installment. See instructions.	10 58,500.00	58,500.00	58,500.00	58,500.00
11	Write the amount of credit carried forward from the prior year.	11 15,000.00	Do not write on this line.	Do not write on this line.	Do not write on this line.
12	Subtract Line 11 from Line 10. If the amount is negative, use brackets. Write in Quarters 2 through 4, the amount from Line 10.	12 43,500.00	58,500.00	58,500.00	58,500.00
13	If the amount on Line 14 of the previous quarter is negative, write that amount as a positive here. Otherwise, write "0."	13 Skip this line for Quarter 1.	0.00	0.00	0.00
14	Subtract Line 13 from Line 12. If the amount is negative, use brackets.	14 43,500.00	58,500.00	58,500.00	58,500.00

Step 3: Figure your unpaid tax

15	Write your total net income and replacement tax. See instructions.		15 260,000.00
16	**a** Write the amount of your credit carryforward from the prior year and your total estimated tax payments made this year.	16a 195,000.00	
	b **Form IL-1120 filers only**: Write the amount from Line 7, or, if you annualized, the total of Line 10. All other filers, write zero.	16b 234,000.00	
	Write the **greater** of Line 16a or Line 16b here.		16 234,000.00
17	Write other payments made **on or before** your original due date.		
	a Write the amount and the date of your Form IL-505-B.	17a ___ __/__/____	
	b Write the amount and the date of any other payment.	17b 65,000.00 03 / 15 / 2008	
	Add Lines 17a and 17b.		17 65,000.00
18	Add Lines 16 and 17.		18 299,000.00
19	Subtract Line 18 from Line 15. If this amount is —***positive,*** write that amount here. Continue to Step 4 and write this amount in Penalty Worksheet 1, Line 21, Column C. —***zero or negative,*** write that amount here and, if negative, use brackets. Continue to Step 4, skip Penalty Worksheet 1, and go to Penalty Worksheet 2. You may apply this overpayment to any underpayment when figuring your Penalty Worksheet 2. See instructions.		19 -39,000.00

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Penalty Worksheet 2 — Late-payment penalty for underpayment of estimated tax

Note → If you paid the required amount from Line 14 by the payment due date on Line 9 for each quarter, do not complete this worksheet.

23 Write the amount and the date of each estimated income tax payment you made. See instructions.

Estimated income tax payments

	Amount	Date paid		Amount	Date paid		Amount	Date paid
a	40,000.00	04 / 15 / 2007	c	40,000.00	09 / 15 / 2007	e		/ /
b	60,000.00	06 / 15 / 2007	d	40,000.00	12 / 15 / 2007	f		/ /

24 Write the unpaid amounts from Line 14, Quarters 1 through 4, on the first line of the appropriate quarters in Column C below.

A Period	B Due date	C Unpaid amount	D Payment applied	E Balance due (Col. C - Col. D)	F Payment date	G No. of days late	H Penalty rate (see above)	I Penalty
Qtr. 1	04 / 15 / 2007	43,500.00	40,000.00	3,500.00	04 / 15 / 2007	0		
		3,500.00	3,500.00	0.00	06 / 15 / 2007	60	.10	350.00
					/ /			
Qtr. 2	06 / 15 / 2007	58,500.00	56,500.00	2,000.00	06 / 15 / 2007	0		
		2,000.00	2,000.00	0.00	09 / 15 / 2007	90	.10	200.00
					/ /			
Qtr. 3	09 / 15 / 2007	58,500.00	38,000.00	20,500.00	09 / 15 / 2007	0		
		20,500.00	20,500.00	0.00	12 / 15 / 2007	90	.10	2,050.00
					/ /			
Qtr. 4	12 / 15 / 2007	58,500.00	19,500.00	39,000.00	12 / 15 / 2007	0		
		39,000.00	39,000.00	0.00	03 / 15 / 2008	90	.10	3,900.00
					/ /			

25 Add Column I, Quarters 1 through 4. This is your **late-payment penalty for underpayment of estimated tax.** Write the total amount here and on Form IL-1120, Step 8, Line 53. 25 6,500.00

To compute the Late ES Payment Penalty manually refer to the IL-2220 instructions

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b) 3-3(b-15)

Corporation P timely files its IL-1120 for the tax year ending December 31, 2003 on March 15, 2004. The income tax liability shown on the return was $260,000. The taxpayer had only made estimated payments totaling $195,000 (including a credit carryforward from 2002 of $15,000); $65,000 tax was paid with the original return. Tax shown on the 2002 return was $300,000.

Estimated payments made for 2003 were as follows:

Credit carryforward from 2002	$15,000
April 15, 2003	40,000
June 15, 2003	60,000
September 15, 2003	40,000
December 15, 2003	40,000
Total estimated payments	$195,000

The Late ES Payment penalty would be calculated in GenTax as follows:

Main Screen:

[redacted]

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Payment/Refund Screen:

[redacted]

Penalty Screen/ES Late Pay Calculator:

[redacted]

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c) 3-3(b-10)(1)

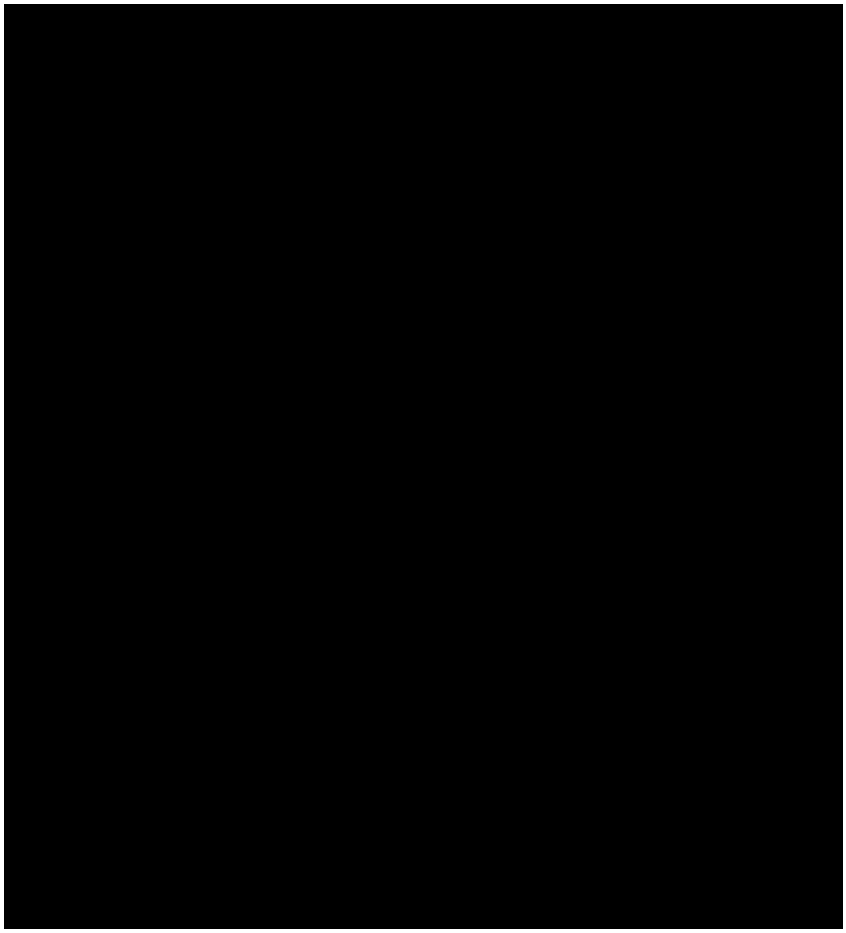
Corporation P timely files its IL-1120 for the tax year ending December 31, 2002 on March 15, 2003. The income tax liability shown on the return was $260,000. The taxpayer had only made estimated payments totaling $195,000 (including a credit carryforward from 2001 of $15,000); $65,000 tax was paid with the original return. Tax shown on the 2001 return was $300,000.

Estimated payments made for 2002 were as follows:

Credit carryforward from 2001	$15,000
April 15, 2002	40,000
June 15, 2002	60,000
September 15, 2002	40,000
December 15, 2002	40,000
Total estimated payments	$195,000

The Late ES Payment penalty would be calculated in GenTax as follows:

Main Screen:



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Payment/Refund Screen:

[redacted]

Penalty Screen/ES Late Pay Calculation:

[redacted]

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d) 3-3(b-5)(1)

Corporation P timely files its IL-1120 for the tax year ending December 31, 1999 on March 15, 2000. The income tax liability shown on the return was $260,000. The taxpayer had only made estimated payments totaling $195,000 (including a credit carryforward from 1998 of $15,000); $65,000 tax was paid with the original return. Tax shown on the 1998 return was $300,000.

Estimated payments made for 1999 were as follows:	
Credit carryforward from 1998	$15,000
April 15, 1999	40,000
June 15, 1999	60,000
September 15, 1999	40,000
December 15, 1999	40,000
Total estimated payments	$195,000

The Late ES Payment penalty would be calculated in GenTax as follows:

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Payment/Refund Screen:

[redacted] of

Penalty Screen/ES Late Pay Calculation :

[redacted]

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e) 3-3(b)(1)

Corporation P timely files its IL-1120 for the tax year ending December 31, 1996 on March 15, 1997. The income tax liability shown on the return was $260,000. The taxpayer had only made estimated payments totaling $195,000 (including a credit carryforward from 1995 of $15,000); $65,000 tax was paid with the original return. Tax shown on the 1995 return was $300,000. Penalty will be doubled for Amnesty.

Estimated payments made for 1996 were as follows:	
Credit carryforward from 1995	$15,000
April 15, 1996	40,000
June 15, 1996	60,000
September 15, 1996	40,000
December 15, 1996	40,000
Total estimated payments	$195,000

The Late ES Payment penalty would be calculated in GenTax as follows:

Main Screen:

[redacted]

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Payment/Refund Screen:

[redacted]

Penalty Screen/ES Late Pay Calculation:

[redacted]

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WITHHOLDING INCOME TAX

Revised 7/2019

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I. Purpose of Chapter

The purpose of this chapter is to give the auditor a general understanding about Illinois Withholding Income Tax. The two major sections of this chapter explain:

1. Withholding tax compliance checks – Section IV.
2. Withholding income tax audit procedures – Section VII.

II. Reference Sources

A. Illinois Income Tax Act

- IITA § 701
- IITA § 704
- IITA § 704A
- IITA § 705
- IITA § 706
- IITA § 710
- IITA § 905(b)(3)

B. Illinois Regulations

- 86 IAC § 100.7010
- 86 IAC § 100.7300
- 86 IAC § 100.7325
- 86 IAC § 100.7380

C. Illinois Statutes

- 35 ILCS 10/ - EDGE Tax Credit Act
- 35 ILCS 25/ - Small Business Job Creation Tax Credit Act

D. Department Publications

- PUB-130, Who is Required to Withhold Illinois Income Tax
- PUB-131, Withholding Income Tax Payment and Filing Requirements
- FY 2014-08, New Withholding and Income Tax Requirements for Purchasers and Sellers of Rights to Future Payments of Illinois Lottery Winnings

E. Department Forms

- Form IL-941, Illinois Withholding Income Tax Return, and IL-941 Instructions
- Form IL-941-X, Amended Illinois Withholding Income Tax Return, and Instructions
- IL-501 Payment Coupon and Instructions
- Booklet IL-700-T, Illinois Withholding Tax Tables

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III. General Information

A. Withholding Rate

The withholding rate is computed on compensation after adjustment for the number of exemptions claimed. These exemptions (or allowances) are based on the number of allowances that an employee claims as recorded on Form IL-W-4, Employee's Illinois Withholding Allowance Certificate.

The following shows the tax rates per year used when calculating withholding:

YEARS	TAX RATE
From 8/1/69 through 12/31/82	2.5%
From 1/1/83 through 6/30/84	3.0%
From 7/1/84 through 6/30/89	2.5%
From 7/1/89 through 12/31/10	3.0%
From 1/1/11 through 12/31/14	5.0%
From 1/1/15 through 6/30/17	3.75%
Starting 7/1/17	4.95%

B. How to Figure Amount to Withhold

For wages and other compensation, subtract any exemptions calculated based on the number of allowances claimed on Form IL-W-4 from the wages or other compensation paid. Multiply the result by the applicable year's rate as stated above.

When calculating amounts to be withheld, the direct percentage method or the automated payroll method may be used. For details, see **Booklet IL-700-T**, Illinois Withholding Tax Tables, on the IDOR website at www.tax.illinois.gov.

C. Tax Credits Claimed Against Withholding

There are two tax credits, provided for through the Department of Commerce and Economic Opportunity (DCEO), which allow certain eligible taxpayers the election to claim these credits against withholding payments. These two are:

- the Small Business Creation Tax Credit – IITA § 704A(h)
- the EDGE Tax Credit – IITA § 704A(g)

Credits may only be claimed by the eligible taxpayer once the DCEO credit certificate has been received. The taxpayer should provide proof of credit certificate if requested by the Department of Revenue. If the credit amount exceeds the amount of total payments due with respect to amounts withheld during the calendar year, excess credit may be carried forward for five years. Ref: IITA § 704A(g) and (h).

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D. Withholding Concerning Illinois Lottery Winnings

1. Purchasers
   Effective on and after January 1, 2014, a purchaser is required to withhold Illinois income tax from the seller when purchasing the rights to future payments of Illinois lottery winnings and submit this withholding to the Department of Revenue.
   - At the end of the calendar year, the purchaser will provide Form 1099-MISC, Miscellaneous Income, to the seller reporting the purchase price paid as income and the amount that was withheld from the purchase price as the Illinois withholding.
   - Companies who purchase Illinois lottery winnings can be identified in GenTax as their FEIN number will be followed by "999". Example: Taxpayer's FEIN # is 12-3456789-999.

2. Sellers
   Previously, when the rights to Illinois Lottery winnings were "sold", only resident sellers had to pay Illinois income tax on the amount of the sale price received and include it as income on Form IL-1040 when filed. Effective for tax years ending on and after December 31, 2013, nonresident sellers must also pay tax on this income and, for purchases made after December 31, 2013, purchasers are required to withhold Illinois income tax from payments made to the seller.

   - Effective on and after January 1, 2014, Form 1099-MISC provided by the purchaser to the seller, will indicate the income amount (sale price) and the withholding amount withheld by the purchaser. These amounts must be reported on the seller's IL-1040.

- Throughout the chapter this "bullet style" has been used to indicate when an Exhibit should be reviewed at the end of the chapter.

IV. Withholding Tax Audit Compliance Check

Moved to Audit Manual Chapter 2.

V. Completion of the SC-137 to Request the Withholding Tax Audit

Moved to Audit Manual Chapter 2.

VI. Withholding Tax Records

Employers must maintain a current and accurate record of all persons for whom Illinois Income Tax is withheld. The records must contain the following information:

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1. Amounts and dates of all payments subject to withholding income tax;

2. Names, addresses, and Social Security numbers of persons receiving payments;

3. Periods of employment, including periods for which compensation was paid while absent due to sickness or injury;

4. Amounts paid by pay period;

5. Copies of monthly, quarterly, and annual returns and all statements required to be filed with the Department;

6. Copies of all federal Forms W-2, W-2G, and 1099-R issued to recipients;

7. Current copy of each employee's Federal Form W-4, Employee Withholding Allowance Certificate;

8. Current copy of each employee's Form IL-W-4, Employee's Illinois Withholding Allowance Certificate;

9. Current copy of each winner's Form IL-W-4-G, Gambling Withholding Exemption Certificate;

10 Current copy of each employee's (when applicable) Form IL-W-5-NR, Employee's Statement of Nonresidence in Illinois;

11. Copies of each Form IL-W-5, Certificate of Residence in Illinois, received from employees;

12. Records of payments for personal services contracts when the income is taxable under IITA § 1405.2; and

13. Records of payments for prizes awarded from contests in Illinois when the income is taxable under IITA § 1405.3.

Taxpayers must keep these records for three years from the due date of the return or the date the return was filed, whichever is later, and provide them to the Department upon request.

VII. Withholding Audit Procedures

This Section should be utilized by the in-house WIT auditors. Any procedural topic not covered in this section/chapter should be addressed by either the auditor's coach or the supervisor over that unit.

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For in-house WIT auditors doing taxpayer research, the following resources can be accessed, if necessary:

- EFSB-160 – used to find individuals who have filed an electronic W-2
- Data Warehouse
- GenTax – EFWZ Query, Web Documents

Note: Anytime that a number is taken from the Data Warehouse (federal information) and transferred onto Audit documentation (i.e. withholding calculation spreadsheet), it is then considered Federal Tax Information (FTI). The spreadsheet created must be attached to the Electronic Audit under Section 01 Audit Information in the FTI Zipped Audit File Folder: FTI Auditor's WIT Worksheet (Sch A). This will trigger the GenTax Federal Tax Information Banner (see below).

GenTax Federal Tax Information Banner

A message (below) is displayed in GenTax when data is presented that contains Federal Tax Information (FTI). Note: Not all accounts in GenTax will show this banner, only when FTI is present.

The message includes a link (i.e. click here) to the IRS required procedure that must be followed if the screen is printed. Therefore, it is highly recommended that screens only be printed when absolutely necessary.

A. Audits of Bankruptcy Accounts

Auditors should check GenTax on audit assignments as received to see if a bankruptcy exists. It is also recommended that auditors question taxpayers on audit assignments to see whether a bankruptcy filing is involved. See Chapter 20 for information concerning bankruptcy.

B. WIT Unverified Payments

When performing any of the in-house WIT audits listed in Section C that follows, it is important to understand what WIT "unverified" payments indicate. Essentially, the taxpayer has overpaid on a given period (such as when the taxpayer paid twice). If that overpayment is not claimed on the following period, the payment remains on the period where paid. Such

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a payment is changed in GenTax to "unverified" in the *Trans Type* as "Adj – Unverified WIT Credit".

The importance of these "unverified" payments is that they can be used against an audit liability, but in that respective period only (they cannot be moved to another period). In order to utilize such a payment, the "unverified" payment must be reversed. This reversal request must go through the auditor's immediate supervisor to the Audit Perfection Supervisor, who will reverse the payment so that it can be applied to the audit liability.

Note: The auditor must utilize the payment on the same day that the reversal is completed. This is important because the payment will revert back to "unverified" overnight. During the reversal day, the auditor needs to utilize the payment through the WIT work papers to ensure the correct P&I calculations are applied.

C. In-House Audit Procedures

NOTE: Audit Flow procedures have changed. Refer to AM Chapter 20 for the new Audit Flow process in the "Audit Submission and Review" section of that chapter.

Withholding (WIT) audits performed by in-house auditors include:

1. Nonfiler or skip filer audits
2. Monthly or semi-weekly audits [after tax year 2016, semi-weekly audits no longer done]
3. Federal Revenue Auditor's Report (RAR) audits

For **all** WIT audits, the following applies:

- Verify that the Audit View has the correct audit periods and filing periods as requested on the SC-137. Screen print examples follow for each type.

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[redacted]

Semi-weekly

[redacted]

RAR

[redacted]

1. Nonfiler or Skip Filer Audit Procedures

a) Initiation Letter

An audit initiation letter (EDA-135 Audit Initiation) must be completed for all Withholding Tax audits and sent to the taxpayer. **This letter is required.**

The audit initiation letter is systemically generated from GenTax when the RAS assigns the audit to the auditor [stage – assigned started]. Letters print in the overnight batch process in Springfield and get mailed directly from the mailroom. If there is an issue with the taxpayer's address, the auditor will need to invalidate the audit initiation letter and manually create a new one. The new letter will batch print from Springfield.

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- See Exhibit A – How to Create the EDA-135.
  Note: If a second Initiation letter needs to be sent, refer to these instructions.

b) Second Request Letter (IDOR8FF)

If the taxpayer does not respond to the Initiation Letter within 30 days, a second request letter will be sent.

While in the Audit View, this letter can be accessed in the Letters sub-tab under the CRM Tab. Click on Add to access this letter in the audit letters listing.

Click on the IDOR8FF title in the Type column.

The user will see this entry screen when accessing the letter. The user enters the data in the custom text box as it should appear in the letter.

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Preview the letter prior to saving to be sure it looks correct and professional. Once the letter is saved it cannot be edited. If a mistake is found after the user saves it, then a new letter must be created. Be sure to invalidate the incorrect letter.

Reminder: This letter is not to be used as a substitute for the GenTax required letters such as the Initiation or Completion letters.

Do not use this letter to confirm conversations with the taxpayer concerning **proprietary information**. An example would be the following: at the conclusion of a plant tour, do not use this form to detail your understanding of the taxpayers manufacturing operation. This information should be placed in a private memo generated outside of GenTax.

c) EDA-70, Information Document Request

Whenever an IDOR8FF is sent out as a second request letter, an EDA-70 must be completed and sent with that second request. The EDA-70 can be accessed on the Department's Intranet, under Work Areas, Audit, Forms. This EDA-70 is a savable, fill-in pdf.

d) Form IL-941

A completed and signed Form IL-941 is needed for any nonfiled period. This should be accomplished by the taxpayer preparing its own IL-941(s). However, there are cases in which the auditor will prepare the IL-941(s) – see (2) below.

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(1) IL-941 prepared by taxpayer: If no withholding information has been received concerning the taxpayer's taxable wages, the auditor must request the taxpayer to prepare, sign, and submit its own Form IL-941(s) for the missing quarter(s).

(2) IL-941 prepared by auditor: If withholding information has been provided concerning the taxpayer's taxable wages, the auditor will need to figure the quarterly compensation and liability for the nonfiled periods by using that provided information. Based on the quarterly calculations, the auditor needs to prepare Form IL-941 for the missing quarters for the taxpayer to sign. **These auditor prepared 941s are only sent with the second request letter, and never with an initiation letter.**

NOTE: Form IL-941 is available on the IDOR web site (www.tax.illinois.gov). A copy of each Form IL-941 prepared by the auditor will be needed for the audit file, while a copy of each would be sent to the taxpayer with the second request letter (if applicable).

Once the taxpayer has been sent the initiation letter, **two** scenarios could result:

(a) The taxpayer submits signed IL-941s for the nonfiled periods.
(b) The taxpayer does not submit signed IL-941s for the nonfiled periods.

NOTE: If the taxpayer submits IL-941s, the IL-941s must be signed. If not signed, then the IDR-916, Signature Declaration, must be issued to the taxpayer. The IDR-916 can be found on the Department's website at www.tax.illinois.gov under Forms, Other.

Each scenario is handled differently as follows:

(a) If the taxpayer submitted signed IL-941s:

- Verify that the taxpayer is properly reporting the withholding due against any information available.
- **RAS Review prior to issuing the EDA-143CA**
- An EDA-143CA, Notice of Audit Results, must be completed and sent to the taxpayer.

See Exhibit G – How to Create the EDA-143 Audit Results Letters.

NOTE: If the taxpayer returns the signed IDR-916 (Signature Declaration) in a timely manner, it is considered the signature for the IL-941s and the above procedure can be followed.

(b) If the taxpayer does not submit signed IL-941s or return the IDR-916 in a timely manner, after being provided by the auditor, for the nonfiled periods:

- Create the WIT Audit Working Paper.

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- See Exhibit B – How to create the Working Papers. Follow the instructions for nonfiler or skip filer audits.

- Create "the Computation of tax, penalty and interest" letter.
  - See Exhibit C – How to create the Computation of tax, penalty and interest letter.

- Create the IL-1904, Results of Withholding Audit.
  - See Exhibit D – How to create the IL-1904.
- Create the EDA-27, Explanation of Adjustments.
  - See Exhibit H – GenTax EDA-27 Example, and
  - Exhibit I – How to create the EDA-27

  The EDA-27 will be completed in and generated through GenTax.

- Create the EDA-122, WIT/IIT Notice of Prop Defcy must be completed.
  - See Exhibit E – How to create the EDA-122.

  - ICB forms (EDA-122, 123, 124 or 125, whichever is applicable) will be issued for **all** audits unless the taxpayer has provided the auditor with signed returns. In the case of a WIT audit, the EDA-122 will be utilized.

    NOTE: Audit Flow procedures have changed. Refer to AM Chapter 20 for the new Audit Flow process in the "Audit Submission and Review" section of that chapter.

    Supervisors must review all audits prior to the issuance of the ICB forms to ensure that appropriate documentation exists to support the auditor's positions and to ensure significant audit issues are not missed by the auditor. Any discrepancy with the auditor's proposal will require that the supervisor discuss further issue development, removal of an issue or request additional documentation be obtained to support the issue. **ICB forms cannot be issued until these items are addressed.**

    i. **Prior to Issuance of ICB forms:** The entire audit should be prepared and submitted to supervisor for review. The auditor will notify the RAS that the audit is ready for the RAS Review. The supervisor must agree with the established audit issues.

    Supervisors must make sure all necessary documentation request forms have been utilized prior to issuing the ICB forms. The Informal Conference Board should not be the forum for which an auditor attempts to secure additional documentation for the audit.

    ii. **Audit agreement after issuance of ICB forms:** If the taxpayer agrees with the audit results after the issuance of the ICB forms and prior to the expiration of the 60 days allowed, they must provide their agreement to

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the auditor **in writing by using the new ICB waiver form.** In those instances, the auditor should issue the EDA-143 Notice of Audit Results letter with the IL-870 within 5 days of such notification.

The following items will be mailed to the taxpayer if properly signed IL-941s are not submitted by the taxpayer for the nonfiled periods:

- Computation of tax, penalty and interest for each year in the tax period
- IL-1904, Results of Withholding Audit
- EDA-122, Notice of Proposed Deficiency
- EDA- 27, Explanation of Adjustments

Once mailed to the taxpayer, the taxpayer has 60 days to respond and could respond back in several ways as follows:

(i) The taxpayer submits IL-941s. Follow the procedures above.

(ii) If the taxpayer sends in a signed ICB Waiver or the taxpayer requests an IL-870 within the ICB period (This request must be in writing). Prepare and send the following correspondence to the taxpayer:

- Update the penalty and interest calculation on the WIT Audit Working Paper
- Create "the Computation of tax, penalty and interest" letter. See Exhibit C.
- Create the IL-1904, Results of Withholding Audit. See Exhibit D.
- Create the IL-870, Waiver of Restrictions.
  - See Exhibit F – How to Create the IL-870.
- Create the EDA-143I, Results – IL-870 Information. See Exhibit G.

(iii) The taxpayer pays the amount on the EDA-122 within the ICB period. Prepare and send the following correspondence to the taxpayer:

- Create the IL-870, Waiver of Restrictions, for a signature. See Exhibit F. (In this case **DO NOT RECALCULATE penalty and interest** as the IL-870 will need to agree with the payment amount shown due on the EDA-122.)
- Create the EDA-143I, Results – IL-870 Information. See Exhibit G.

(iv) The taxpayer does not respond within the ICB period, prepare and send the following correspondence to the taxpayer:

- Update the penalty and interest calculation on the WIT Audit Working Paper
- Create "the Computation of tax, penalty and interest" letter. See Exhibit C.
- Create the IL-1904, Results of Withholding Audit. See Exhibit D.
- Create the IL-870, Waiver of Restrictions. See Exhibit F.

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- Create the EDA-143I, Results – IL-870 Information. See Exhibit G.

2. Monthly or Semi-Weekly Audit Procedures

NOTE: After tax year 2016, semi-weekly audits are no longer done.

a) Initiation Letter

An audit initiation letter (EDA-135 Audit Initiation) **must** be completed for **all** Withholding Tax audits and sent to the taxpayer. **This letter is required.**

The audit initiation letter is systemically generated from GenTax when the RAS assigns the audit to the auditor [stage – assigned started]. Letters print in the overnight batch process in Springfield and get mailed directly from the mailroom. If there is an issue with the taxpayer's address, the auditor will need to invalidate the audit initiation letter and manually create a new one. The new letter will batch print from Springfield.

- See Exhibit A – How to Create the EDA-135.
  Note: If a second Initiation letter needs to be sent, refer to these instructions.

(1) If the taxpayer responds to the initiation letter with completed schedules:
(a) If the quarterly withholding tax matches the IL-941s filed:

- Create the WIT Audit Working Paper.
  - See Exhibit B – How to create the Working Papers. Follow the instructions for monthly or semi-weekly audits.

- Create "the Computation of tax, penalty and interest" letter.
  - See Exhibit C – How to create the Computation of tax, penalty and interest letter.
- Create the EDA-27, Explanation of Adjustments.
  - See Exhibit H – Gentax EDA-27 Example, and
  - Example I – How to create the EDA-27

  The EDA-27 will be completed in and generated through GenTax.

- Create the Audit Notice of P&I WIT (EDA-150WA) available in GenTax.
  - See Exhibit M – EDA-150WA.
  Since no additional tax is assessed, penalty and interest is deemed assessed, therefore the EDA-150WA is needed. An IL-870 is not issued to the taxpayer in this case. Two copies of the EDA-150WA will be needed, one for the audit file and one for the taxpayer.

- Create the IDOR-8-FF. See above on how to generate the IDOR-8-FF. Needs sent with the EDA-150.

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Also, an EDA-143I will need to be generated in GenTax to set the indicator. However, this 143I will not be sent to the taxpayer.
See Exhibit G on the EDA-143 series.

NOTE: The taxpayer does not get ICB rights as no additional tax is being assessed.

(b) If the quarterly withholding tax does not match the IL-941s filed:

- Correspond with the taxpayer to secure amended returns for any discrepancies in their reporting.
- Once resolved, proceed with the procedure for matching withholding tax above.

(2) If the taxpayer does not respond to the initiation letter with completed schedules:

- A second request letter (IDOR8FF) will be sent after 30 days. See Section C.1.b above for more information on the IDOR8FF. An EDA-70 will also be sent with the second request. See Section C.1.c above.
- Create the WIT Audit Working Paper. See Exhibit B – How to create the Working Papers. Follow the instructions for monthly or semi-weekly audits.
- Create "the Computation of tax, penalty and interest" letter. See Exhibit C – How to create the Computation of tax, penalty and interest letter.
- Create the EDA-27, Explanation of Adjustments. See Exhibit H – GenTax EDA-27 Example, and Example I – How to create the EDA-27. This form will be completed in and generated through GenTax. The auditor will need two copies of the EDA-27, one for the audit file and one for the taxpayer.
- Create the Audit Notice of P&I WIT (EDA-150WA) available in GenTax. See Exhibit M – EDA-150WA. Since no additional tax is assessed, penalty and interest is deemed assessed, therefore the EDA-150WA is needed. An IL-870 is not issued to the taxpayer in this case. Two copies of the EDA-150WA will be needed, one for the audit file and one for the taxpayer.
- Create the IDOR-8-FF. Needs to be sent with the EDA-150. Also, an EDA-143I will need to be generated in GenTax to set the indicator. However, this 143I will not be sent to the taxpayer. See Exhibit G on the EDA-143 series.

NOTE: The taxpayer does not get ICB rights as no additional tax is being assessed.

The taxpayer must respond with payment within 30 days of the issue date of the Notice and Demand. Taxpayer's response could be as follows:

a) The taxpayer provides payment for the Notice and Demand amount. In doing so, the taxpayer is agreeing to the audit, and the audit will be closed as "AP".

b) The taxpayer does not respond. In this case the audit will be closed as "AL".

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3. Federal RAR Audit Procedures

Changes presented through a federal Revenue Auditor's Report (RAR) may warrant a withholding audit on the RAR adjustment(s). These federal changes could be 3402 or 3509 adjustments, or a combination of adjustments. Dependent upon which type of adjustment has been made different information will be requested from the taxpayer.

Important Note: If there is a combination of 3402 and 3509 adjustments together, separate audit tracks must be set up, as these two issues cannot be processed on the same track. An SC-137 will be completed for a second audit track. Two WIT audits would be needed for that particular taxpayer to address these adjustments separately, as there will be two different penalties – 10% for tax already paid and 15% when tax is due. **Exception:** If the taxpayer has filed returns, establishing a second audit would not be necessary to address these adjustments (can be accomplished within one track).

- **3402** adjustments consist of: (1) a federal nonfiler or (2) an increase in federal taxable wages (under reporters). The 886A may need to be requested, which shows what adjustments were made.
  - A federal nonfiler – original IL-941s need to be filed. May need to compare the federal Form 941 returns to any IL-941s provided.
  - Under reporters – includes "fringe benefits" not properly reported as income. Fringe benefits may include: phones, cars, gift cards, concert tickets, bonuses, etc. May need a break down of fringe benefits affecting Illinois employees. IL-941-Xs may need to be filed.

- **3509** adjustments consist of: mis-classification of independent contractors, or subchapter S-corporation officers per federal adjustment, are reclassified as employees.
  - Reclassified employees – request SSNs, copies of 1099s. May also need information on the wage adjustment, or a copy of the federal Form1040 returns for these employees.
    Generally, these workers should have reported this income on their IL-1040 returns. Since no additional tax would be required, only penalty and interest would apply. The penalty is 10%, while the interest would be calculated through the April 15 filing date of the next year.
    If these workers did not report this income, the auditor would issue letters to the employer. In such case, the penalty is 15%, while the interest would be calculated through the letter issued date (not April 15).

a) IRS Documentation

IRS documentation provides necessary information for RAR audits. When utilizing this documentation, it is important to realize the following:

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Form 4666, Summary of Employment Tax Examination, may provide in the "Other Information" comment section the reasons for reclassifying workers as employees.

b) Initiation Letter

An audit initiation letter (EDA-135 Audit Initiation) must be completed for all Withholding Tax audits and sent to the taxpayer. **This letter is required.**

The audit initiation letter is systemically generated from GenTax when the RAS assigns the audit to the auditor [stage – assigned started]. Letters print in the overnight batch process in Springfield and get mailed directly from the mailroom. If there is an issue with the taxpayer's address, the auditor will need to invalidate the audit initiation letter and manually create a new one. The new letter will batch print from Springfield.

- See Exhibit A – How to Create the EDA-135.
  Note: If a second Initiation letter needs to be sent, refer to these instructions.

Dependent on the type of adjustment(s) made, the following may need to be prepared. Refer to AM Chapter 20 for the new Audit flow process. See the "Audit Submission and Review" section in that chapter.

- Workpaper for the audit needs to be completed.
  - See Exhibit B – How to create the Working Papers. Follow the instructions for nonfiler or skip filer audits, and RAR audits.

Note: "Type of Audit" on the working paper will be dependent on the RAR adjustment. For nonfilers and reclassification of workers, the "type" should be "WIT Q Referral". For under reporters, the "type" should be "Fed Rev Agents Report". See specific instructions within Exhibit B on working papers.

- The Computation of tax, penalty and interest letter will be completed.
  - See Exhibit C – How to create the Computation of tax, penalty and interest letter.

- The EDA-122, WIT/IIT Notice of Prop Defcy must be completed.
  - See Exhibit E – How to create the EDA-122.
  - Read the information pertaining to ICB forms in Section 1. (Nonfiler or Skip Filer Audit Procedures) above.

- The Audit Notice of P&I WIT (EDA-150WA) available in GenTax.
  - See Exhibit M – EDA-150WA.

  Since no additional tax is assessed, penalty and interest is deemed assessed, therefore the EDA-150WA is needed. An IL-870 is not issued to

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the taxpayer in this case. Two copies of the EDA-150WA will be needed, one for the audit file and one for the taxpayer.

- IDOR-8-FF will need to be sent with the EDA-150.

  Also, an EDA-143I will need to be generated in GenTax to set the indicator. However, this 143I will not be sent to the taxpayer.
  See Exhibit G on the EDA-143 series.

(1) The following items will be sent to the taxpayer for an adjustment that creates additional tax:

- The Initiation Letter
- Second Request letter (if applicable), along with an EDA-70. See Section C.1.b above on the IDOR8FF and Section C.1.c above on the EDA-70.
- Computation of tax, penalty and interest for each year in the tax period
- EDA-122, WIT/IIT Notice of Proposed Deficiency

If the taxpayer agrees with the audit results, the following must be performed in order to complete the audit process:

- The penalty and interest on the workpaper must be updated. This can be done by opening the workpaper and clicking CALC PNI. This will update the interest through the current date.
- IL-1904, Results of Withholding Audit must be completed. See Exhibit D.
- IL-870, Waiver of Restrictions. See Exhibit F. (The auditor will need to **recalculate the penalty and interest**, if the IL-870 is being prepared more than one week after the workpapers are prepared.)
- EDA-143I, Results – IL-870 Information. See Exhibit G.

The taxpayer will then be issued a copy of each of the following:

- Results of Withholding Audit (IL-1904)
- Waiver of Restrictions (IL-870)
- Results- IL-870 Information (EDA-143I).

(2) The following items will be sent to the taxpayer for an adjustment that only warrants penalty and interest, no additional tax:

- The Initiation Letter
- Second Request letter (if applicable) with any computation worksheet, along with an EDA-70. See Section C.1.b above on the IDOR8FF and Section C.1.c above on the EDA-70.
- Computation of tax, penalty and interest for each year in the tax period
- EDA-150WA, Audit Notice of P&I WIT.
- IDOR-8-FF. An EDA-143I will need to be generated in GenTax (but not sent to the taxpayer) to set the indicator.

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4. Amended Return Procedures

There are instances in which amended returns (IL-941-Xs) may be received. The three most common are:

- An amended with no original return on file
- An amended with an estimated return
- An amended for claim

The procedures for addressing these returns will vary dependent of the particular taxpayer and any information available on that taxpayer.

D. Amnesty Issues in WIT Audits

There are two issues concerning Amnesty that the auditor should be aware of during a WIT audit.

- When using the GenTax P&I calculator for the 2009 tax year, the calculator does not correctly calculate the second quarter for Amnesty double penalty and interest. The calculation for this quarter must be done manually.

- For RAR audit, if the finalization date falls after November 8, 2010 (the last payment date of the 2010 Amnesty Program), Amnesty P&I does not apply unless the taxpayer was a nonfiler.

E. Taxable Commuter Reimbursement as Wages for TY 2015

Prior to 2016, employers who offered commuter benefits (Illinois Transit Benefit - mass transit/vanpool expenses) to their employees that exceeded the $130 per month limit on tax-free benefits, treated the excess as taxable wages on which withholding was due and would report those wages as taxable on the employees' W-2s.

With the passage of PL 114-113 (in 2016), the tax-free benefits limit was increased to $250 for the period from January 1, 2015 through December 31, 2015 (effectively retroactive). Due to this increase, the employers should have adjusted their reporting of taxable wages, but because the legislation was not signed until 2016, such adjustment was not possible for the 2015 tax year. Concerning these commuter benefits, excess may have been withheld for these employees in 2015.

Since these benefits are not subject to federal income tax or to Illinois income tax (State follows the federal determination), there may be an impact on audits for the 2015 tax year. This benefits change would most likely increase overpayments on returns filed since additional tax would have been withheld on income that has since become non-taxable (the increase in benefits from $130 to $250).

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Note: Per this legislation, the applicable statutory monthly limit for 2016 will be $255 per month.

F. Completing the Withholding Audit

In response to the issuance of an IL-870, the taxpayer may:

- sign the IL-870 and pay the amount due
- sign the IL-870 without paying
- not sign the IL-870 but pay the amount due
- ignore the information sent and do nothing. In such a case, if the taxpayer fails to respond to the IL-870 after 45 days, the auditor closes the audit and submits it to the supervisor for review.

How the taxpayer responds determines how the working paper is completed for audit closure.

1. Agreed Audits

- In cases when the taxpayer pays the amount due, whether or not the taxpayer signs the IL-870, the audit is agreed paid (AP).
- If the IL-870 is signed, then the date it is signed will be the statute date that will be entered on the working paper in GenTax.
- If the IL-870 is not signed, then the statute date entered on the working paper in GenTax will be the date the payment was received (envelope date).

The Audit working paper should then be updated based on this information so that the audit can be prepared for closure. The following needs to be performed to change the working paper for an agreed liability.

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The Working Paper information screen will open. Click on the Change Tab to update the working paper.

Once the changes have been made, click on the Save button.

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[redacted]

2. Unagreed Audits

In cases where the audit is unagreed, the IL-870 issued date will be entered as the statute date on the working papers. (See the above screen for adding the statute date). The liability would remain marked as "unagreed liability" and not changed.

3. Closing Letters – Audit Completion Letters (EDA-143 series)

The Audit Completion letter sets the Audit Completion Indicator. The date in the Indicator is used to calculate the UPIA 5 penalties at 20% on additional tax due after an audit has been completed. Without the Indicator the UPIA 5 penalties cannot be calculated correctly. Therefore, all audits must have an Audit Completion Letter (generated through GenTax) sent to set this indicator.

There are several closing letters available in the EDA-143 series dependent on the auditor's needs for withholding audits. These letters are:

- EDA-143CA, Results- Return Approv
- EDA-143I, Results- IL-870 Information
- EDA-143NC, Results- No Liability

Utilization of the EDA-143 has been previously discussed within the audit procedures.

See Exhibit G – How to Create the EDA-143 Audit Results Letters.

4. Documentation required in the Audit File

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Dependent on the type of WIT audit performed, the documentation required may vary.

- EDA-51 WIT – Withholding Audit Index
  This index provides the listing of documentation that may be utilized in a WIT audit. An EDA-51 WIT should be completed and used as a directory of the documents within the audit. See Exhibit L – Withholding Audit Index (EDA-51 WIT).

  - The EDA-51 WIT Audit Index is available on the Intra-net under Work Areas, Audit, Forms, Income Tax. This EDA-51 is a fill-in pdf, which is savable and printable.

- All items indicated in the audit type procedure above (nonfiler, skip filer, monthly & semi-weekly, RAR).

- Any other documents as indicated on the EDA-51 WIT for that particular audit.

- Completed Prod-1: Use the following codes as they apply on the Prod-1 for the withholding tax audit

  92 2010 Amnesty Interest
  93 2010 Amnesty Penalty
  96 Interest
  97 Amnesty Interest
  98 Penalty
  99 Amnesty Penalty

  260.00 WIT IL NF
  261.00 COMP NOT W/H NF NP
  262.00 W/H NOT PD
  263.00 WIT IITS 706 EMP P&I
  264.00 IRC 3509 RECLASS
  265.00 WIT NF FF

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VIII. Exhibits – WIT Audit Procedures

Print as needed to mail, if necessary. (Be Green).

NOTE: Audit Flow procedures have changed. Refer to AM Chapter 20 for the new Audit Flow process in the "Audit Submission and Review" section of that chapter.

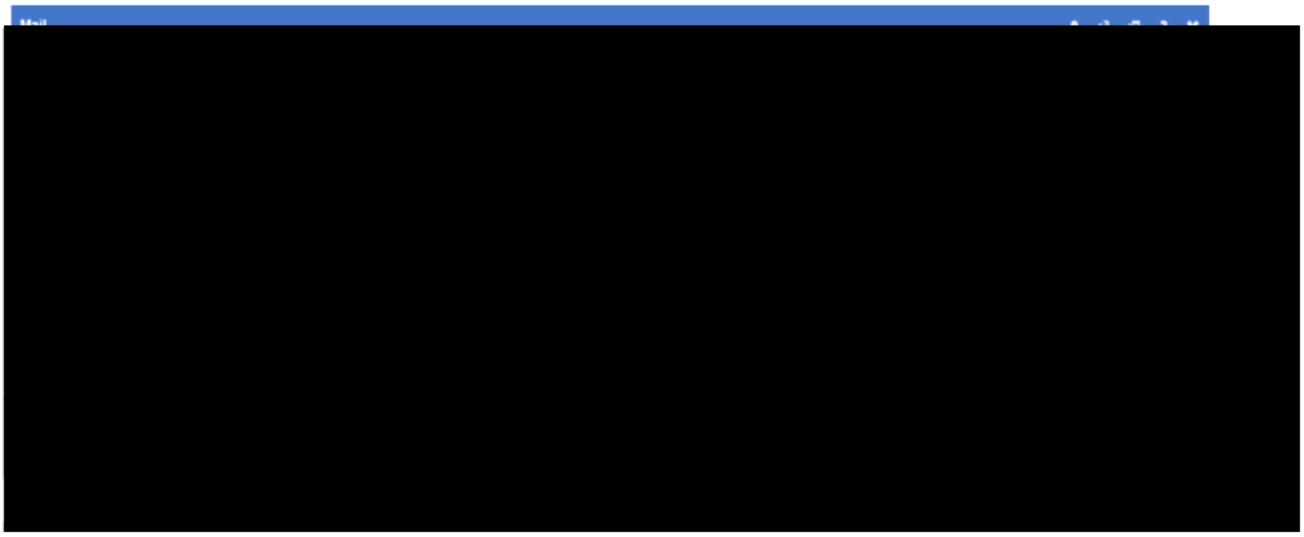
The audit initiation letter is systemically generated from GenTax when the RAS assigns the audit to the auditor [stage – assigned started]. Letters print in the overnight batch process in Springfield and get mailed directly from the mailroom. If there is an issue with the taxpayer's address, the auditor will need to invalidate the audit initiation letter and manually create a new one. The new letter will batch print from Springfield.

A. Exhibit A - How to Create the EDA-135

Note: If a second Initiation letter needs to be sent, refer to these instructions.

When in the Audit View of the audit needing the initiation letter sent, click on the CRM Tab, then the Letters sub-tab. Then to generate the letter, click on "Add".

Click the EDA-135 title in the Type column and complete the initiation letter.



The Audit Initiation Letter screen opens. By clicking on "Quick View" the letter can be reviewed before saving [click on the "Save" button to save this letter].

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Any information entered in the Note text box will generate a new CRM mail type note.

REMEMBER: ONCE THE LETTER IS SAVED, IT IS ALWAYS IN GENTAX. If you save the letter and discover it is incorrect, you must invalidate the letter.

Invalidating a Letter

To invalidate a letter, open the initiation letter that was just created, by clicking on the letter ID hyper-link under *Letter ID*.

By clicking on "Next", a drop-down box opens and to invalidate the letter click on "Mark as Not Valid".

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A Comment Box will open allowing the user to type in a reason as to why the letter is being invalidated. This is not required. Click the “OK” button.

The letter is now invalidated.

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B. Exhibit B – How to Create the Working Papers

1. Nonfiler or Skip Filer Audits, and RAR Audits

In the Audit View, click on the Working Papers sub-tab under the Audit Tab. Click on Add to add a working paper.

This screen will pull all of the audit periods. Click on the first audit period.

Select the appropriate working paper type. Enter the type of audit by clicking on the appropriate choice for that particular audit from the list (see screen below). For tax years ending in 2011 and prior, choose either "Fed Rev Agents Report" or "WIT Q Referral" dependent on the audit. For tax years ending after 2011, choose the appropriate tax year specific type. Example: Audit is on a skip filer for 2012, so "WIT Q Referral 2012" would be selected.

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The Working Paper entry screen will open. The Statute Date is required.

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Select Unagreed Liability – This needs to be selected until the auditor receives signed returns, until the auditor receives a signed IL-870, or until payments have been received.

Click on the Fill in Tax Difference tab

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Once entered, click back on the Main Tab and verify that the total tax amount equals the total tax amount that has been figured for the audit. Click on Save.

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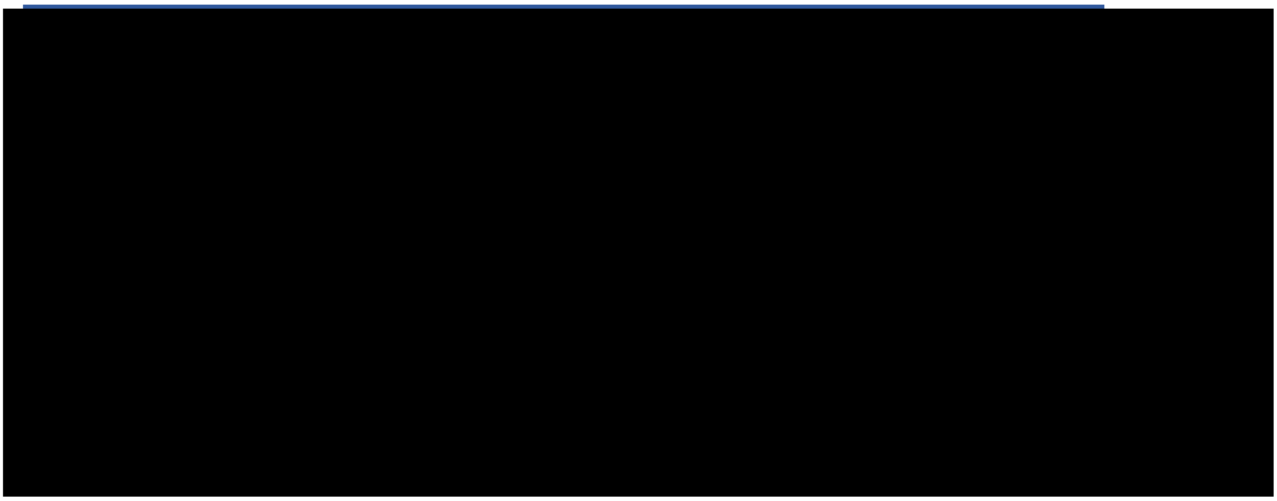
Following the save, the auditor will need to click Calc PNI. The penalty and interest amounts will be added to the audit workpaper.



2. Monthly or Semi-weekly Audits

NOTE: After tax year 2016, semi-weekly audits are no longer done.

First, the auditor will need to complete Working Papers for the audit. A separate workpaper will be needed for each year in the audit. In the Audit View, click on the Working Papers sub-tab under the Audit Tab. Click on Add to add a working paper.

This screen will pull all of the audit periods. Click on the first audit period (3/31/06).

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Select the first period of the year for the working paper that is needed. If more than one year in the audit the auditor would need to select the first quarter of each year to complete the working paper for that year.

[redacted]

Select the working paper type, by clicking on the appropriate choice for that particular audit (see screen below).

[redacted]

Both monthly and semi-weekly audits will be an agreed liability as there will be no tax change, only penalty and interest will be assessed. Example - the Semi Wkly Wp screen below. All quarters of the year must have the boxes checked before the working paper is completed.

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NOTE: After tax year 2016, semi-weekly audits are no longer done. The below information in a) is being left in this chapter for its historical value.

a) For semi-weekly audits, click on the Semi-Weekly Compliance Q1 tab to begin. Each quarter will have to be opened and completed for each year in the audit.

Complete the Amount Withheld column by entering the Illinois tax liability on the dates the amounts were withheld per the taxpayer's records. (Tax is considered withheld the day the employee is issued a paycheck.) This has to be completed for each quarter in which the taxpayer has withheld Illinois tax.

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Repeat for each quarter that has data to be completed (click on the Q2, Q3 and Q4 tab for each entry), and enter the tax liability on the dates the tax was withheld. It should be noted that the total tax amounts for each quarter need to match the tax that is reported on the IL-941s for each quarter.

Once the quarters are completed, click on the Main Tab. Check that the figures are correct, then click Save.

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[redacted]

Following the save, the auditor will need to click Calc PNI. When Calc PNI is selected the system will pull all of the payment dates and will properly calculate the penalty and interest for the workpaper.

[redacted]

b) For monthly (Qrt Monthly) audits, the working paper screen is designed differently (than the semi-weekly) as the compliance grid allows for all months to be entered on a single grid. Click on the Quarter Monthly Compliance Grid Tab to open.

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Enter the Amount Withheld for all of the applicable months (January through December). Only January and February are shown on this screen print.

Once amounts have been entered, click on the Main Tab. Check that the figures are correct, then click Save.

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Following the save, the auditor will need to click Calc PNI. When Calc PNI is selected the system will pull all of the payment dates and will properly calculate the penalty and interest for the workpaper.

3. Annual WIT work paper

In addition to the WIT Monthly WP in GenTax, an “annual” WIT work paper has been developed and is available for use. In the Audit View, click on the Working Papers sub-tab under the Audit Tab. Click on Add to add a working paper.

This screen will pull all of the audit periods as shown below. Both WIT Monthly and Annual WPs can be accessed once the appropriate period has been selected.

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[redacted]

Click on WIT Annual WP to open the work paper for completion.

[redacted]

[redacted]

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C. Exhibit C – How to Create the Computation of Tax, Pen, & Int Letter

The auditor must click the Letter Tab for the Working Paper to complete Computation of Tax, Pen, & Int (ILCWFPI).

The Input screen will open. A four-digit year must be entered in the Year box. This letter will have to be created for each tax year in the audit period. (For example, enter the year as 2012) Click the Preview Letter tab to verify that all data is correct, then click Save.

Once saved, go to the CRM Tab and click on the Letters sub-tab. The first letter listed should be the Computation of Tax, Pen & Int. just generated. The letter detail can be viewed by clicking on the Letter ID number.

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[redacted]

The Computation of Tax, Pen, & Int must be completed for **each** year within the audit period. Two copies of each computation for the various years will be needed, one for the audit file and one for the taxpayer. Follow the same procedures above for each year.

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D. Exhibit D – How to Create the IL-1904, Results of Withholding Audit

Click on the Letters sub-tab under the CRM Tab in the Audit View, then click on Add to access the letters.

Click on the IL1904 title in the Type column.

The Input screen opens. Once applicable information has been entered, click Save.

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[redacted]

Once saved, the first letter listed under the Letters sub-tab should be the Results of Withholding Audit just generated. The letter detail can be viewed by clicking on the Letter ID number.

[redacted]

Two copies of the IL1904 will be needed, one electronic for the audit file and one paper for the taxpayer.

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E. Exhibit E – How to Create the EDA-122, WIT/IIT Notice of Prop Defcy

Click on the Letters sub-tab under the CRM Tab in the Audit View, then click on Add to access the letters.

Click on the EDA-122 title in the Type column.

The Input screen opens. Once applicable information has been entered (if needed), click Save.

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Once saved, the first letter listed under the Letters sub-tab should be the WIT/IIT Notice of Prop Defcy just generated. The letter detail can be viewed by clicking on the Letter ID number.

[redacted]

Two copies of the EDA-122 will be needed, one electronic for the audit file and one paper for the taxpayer.

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F. Exhibit F – How to Create the IL-870, Waiver of Restrictions

Click on the Letters sub-tab under the CRM Tab in the Audit View, then click on Add to access the letters.

Click on the IL-870 title in the Type column.

The Input screen opens. Once applicable information has been entered (Issuance Date is a required entry), click Save.

Note: Remarks may need to be added to the IL-870 in the Remarks box. The most common situations that warrant "remarks" are: (1) outstanding payments that are to be applied such as estimated payments, and (2) the doubling of Penalty & Interest under Amnesty. Remarks example: "Estimated payments in the amount of $500.00 were received for account period ending 9/30/2010. Your liability will be reduced by $500.00. Therefore, your total liability due is $1,200.00 ($1,700.00 - $500.00)."

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[redacted]

The Note box will generate a mail type CRM note viewable by anyone in the Department.

Once saved, the first letter listed under the Letters sub-tab should be the Waiver of Restrictions just generated. The letter detail can be viewed by clicking on the Letter ID number.

[redacted]

Two copies of the IL-870 will be needed, one electronic for the audit file and one paper for the taxpayer. **Note**: If the IL-870 is issued more than one week after the workpapers are prepared, then prior to printing the IL-870, the auditor must update the penalty and interest (P&I) on the working paper. See details on updating the P&I in Exhibit B (Working Papers) above. Interest must be updated through the current date.

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G. Exhibit G – How to Create the EDA-143 Audit Results Letters

There are several closing letters available in the EDA-143 series dependent on the auditors' needs for withholding audits. These letters are:

- EDA-143CA, Results- Return Approval
- EDA-143I, Results- IL-870 Information
- EDA-143NC, Results- No Liability

All of these closing letters can be accessed as follows:

Click on the Letters sub-tab under the CRM Tab in the Audit View, then click on Add to access the letters.

Choose the appropriate letter by clicking on the letter title in the Type column.

The following screen instructions apply to any of the EDA-143 series letters. However, the EDA-143CA may require additional information input, refer to **Audit Manual Chapter 20, Exhibit K** for complete details on the completion of the EDA-143CA.

The Input screen opens. Once applicable information has been entered (Completion/Issuance Date is a required entry), click Save.

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[redacted]

Once saved, the first letter listed under the Letters sub-tab should be the particular Audit Result Letter just generated. The letter detail can be viewed by clicking on the Letter ID number.

[redacted]

Two copies of the EDA-143 will be needed, one electronic for the audit file and one paper for the taxpayer.

Each type of EDA-143 letter will be addressed individually as to the proper use.

1. EDA-143CA, Results Return Approval

The EDA-143CA allows for an audit that contains both original and amended returns. Since this letter will summarize the results of multiple years in many instances, it is important to have the details about each year readily available when generating the letter.

NOTE: It is important that this letter (EDA-143CA) NOT be issued until the audit findings are finalized. The issuance of this “results” letter or any of the other “results” letters sets indicators and transactions which can impact the taxpayer’s account.

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2. EDA-143I, Results – IL-870 Information

The EDA-143I is used when issuing an IL-870, Waiver of Restrictions. Also used just to set the indicator (in such a case, the EDA-143I would not be sent out to the taxpayer).

3. EDA-143NC, Results – No Liability

The EDA-143NC is used for audits in which no liability has been assessed.

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H. Exhibit H – EDA-27 Example

Explanation of Audit Adjustments
Income Tax

STATE OF Illinois DEPARTMENT OF REVENUE tax.illinois.gov

June 13, 2019

141 W JACKSON
CHICAGO IL 606

Letter ID:
Taxpayer ID: XXX-3
Account ID: P2006
Audit ID: A1175
Return type: IL-1040
Audit periods: 01/2003 - 12/2007

Explanation of adjustments for tax period ending 12/31/2006	Return impact	Tax impact
We have determined that you were required to file an income tax return. Since you did not file a return, we have computed your Illinois Income Tax liability based on the information that we have available. [35 ILCS 5/502(a), 904(b)]	$10,000.00	$300.00

Preview

EDA-27 (R-11/15)

I. Exhibit I - How to Create the EDA-27

The EDA-27 is generated through GenTax.

Click on the Letters sub-tab under the CRM Tab in the Audit View, then click on Add to access the letters.

Choose the EDA-27 by clicking on the letter title in the Type column.

Click on the Filing Period down arrow to open the available filing periods. The EDA-27 for WIT is based on calendar year so that a different letter is not required for every filing period (quarter). For example, the audit for the EDA-27 below includes all quarters from March 31, 2013 through December 31, 2015. But the filing periods only reflect calendar year ends. Click on the appropriate period.

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[redacted]

The Paragraph Section will open to allow the appropriate paragraphs to be chosen by clicking on the yellow box for that paragraph.

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Box will turn blue when chosen. After choosing the appropriate paragraphs, click the Preview Letter tab at the top of the Input Screen to verify that all data is correct, then click Save.

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J. Exhibit J – Notice and Demand Letter

Exhibit removed. No longer a letter created in Word. See Exhibit M below as to the creation of the EDA-150WA through GenTax.

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K. Exhibit K – Closing Letter

Date: November 20, 2012

FEIN: 20-0000000
Form: IL-941
Audit ID: A0123456789
Audit period: 1/2008-12/2008

TAXPAYER COMPANY INC
ATTN: BIG BOSS
1000 MAIN AVE
ANYTOWN IL 66666-6666

Dear Taxpayer:

This letter is to notify you that your audit for the tax type and audit period shown above has been tentatively completed, as of November 20, 2012.

The attached EDA-150, Notice and Demand, shows your outstanding balance due.

Please make your check payable to the "Illinois Department of Revenue" and return in the enclosed envelope for proper processing *within 30 days of the date of this letter*.

All audits are subject to review. If no changes are made, you will receive a Notice of Audit Closure. You will be notified if additional information is needed.

If any remaining penalty and/or interest are due, you will receive a bill.

If you have any questions, please call me at the number below.

Sincerely,

Auditor's Name
Revenue Auditor
ILLINOIS DEPT OF REVENUE
Auditor's Phone Number
Auditor's Fax Number

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L. Exhibit L – Withholding Audit Index (EDA-51 WIT)

Use your mouse or Tab key to move through the fields. Use your mouse or space bar to enable check boxes.

Illinois Department of Revenue

EDA-51-WIT Withholding Income Tax Audit Index and Checklist

Taxpayer: Audit ID: Date:

FEIN/SSN: Audit period: Statute:

All forms should be in date order.

A. Processing Forms

- ( ) Federal income tax information
- ( ) PROD-1 - Audit Results
- ( ) EDA-51
- ( ) IL-872
- ( ) IL-870
- ( ) IL-1904
- ( ) EDA-27
- ( ) Payment voucher
- ( ) Auditor's comments
- ( ) EDC-5
- ( ) IL-2848 - Power of attorney
- ( ) ICB folder (recommendation)
- ( ) EDA-70 - Information request
- ( ) EDA-154 - Email authorization
- ( )

B. Schedules

- ( ) Computation of withholding tax, penalty and interest due (gentax working paper)
- ( ) Original IL-941(s)
- ( ) Amended IL-941-X(s)
- ( ) Schedule A - Auditor's withholding worksheet
- ( ) Penalty and interest calculations
- ( )

C. Supporting documentation for audit schedules

- ( ) Referral supporting documentation
- ( ) EFS query reports
- ( ) IDES reports
- ( )

D. Other

- ( ) EDA-135 - Audit Initiation
- ( ) IDOR-8-FF
- ( ) EDA-122 - Notice of Proposed Deficiency
- ( ) EDA-124 - Notice of Proposed Deficiency and Claim Denial
- ( ) EDA-125 - Notice of Proposed Claim Denial
- ( ) EDA-143 -Closing letter
- ( ) EDA-150 - Penalty and interest notice
- ( ) WIT filing history
- ( ) CIT filing history
- ( ) ROT filing history
- ( ) IIT filing history
- ( ) Copy of IL-941
- ( ) Copy of IL returns
- ( ) Copy of US return - provided by taxpayer
- ( )

E. Internet research

- ( ) IL SOS
- ( ) Manta or similar service
- ( ) Westlaw (if needed)
- ( ) Google or similar service
- ( ) White or yellow pages
- ( ) Taxpayer correspondence
- ( )

F. Perfection and Review

1	All indicators addressed	☐ Yes	☐ No
2	All work items addressed	☐ Yes	☐ No
3	All payment holds released	☐ Yes	☐ No
4	Any overpayments addressed	☐ Yes	☐ No
5	If a refund, refund created	☐ Yes	☐ No

6 Other:

Reviewer: Date:

EDA-51-WIT (N-11/16)

Reset Print

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M. Exhibit M – How to Create the Audit Notice of P&I WIT (EDA-150WA)

Click on the Letters sub-tab under the CRM Tab in the Audit View, then click on Add to access the letters.

[redacted]

Click on the blue EDA-150WA in the Type column under Mail Types.

[redacted]

The Input screen opens. Once applicable information has been entered, click Save.

[redacted]

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N. Exhibit N – Employee vs. Independent Contractor Questionnaire

Illinois Department of Revenue

Employee vs. Independent Contractor Questionnaire:

The purpose of this document request is to obtain information for the determination as to whether workers are employees or independent contractors. Mistakenly classifying an employee as an independent contractor can result in significant fines and penalties. The IRS has established 20 factors that are helpful in determining an employer-employee relationship. The Illinois Department of Revenue has based this questionnaire on those same 20 factors. Copies of any documentation supporting answers to these questions, especially including any agreement between the worker and the employer, should be provided when responding back to the below questions.

1. **Profit or loss.** Can the worker make a profit (other than the wages that would ordinarily accrue to an employee) or suffer a loss as a result of the work?

2. **Investment.** Does the worker have an investment in the equipment and facilities used to do the work?

3. **Works for more than one firm.** Does the person work for more than one company at a time?

4. **Services offered to the general public.** Does the worker offer the same services to the general public?

5. **Instructions.** Is the worker given instructions about when, where and how to do the work?
   Who determines such work assignments – "employer" or worker?
   Does the "employer" have control over all of the factors concerning the work/job?

6. **Training.** Is training provided for the worker to do the job in a particular manner as determined by the "employer"?

7. **Integration.** Are the worker's services so important to the business that they have become a necessary part of that business?

8. **Services rendered personally.** Must the worker provide the services personally, as opposed to delegating tasks to someone else?

9. **Hiring assistants.** Who is responsible for the hiring, supervising and paying of the worker's assistants?

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10. **Continuing relationship.** In there an ongoing relationship between the worker and the business that hired this worker?
    Does the worker receive benefits, such as insurance, pension, or paid leave?

11. **Work hours.** Who is responsible for setting the worker's hours?

12. **Full-time work.** Must the worker spend all of his/her working time on this company's job only?

13. **Work done on premises.** Must the individual work on the business premises, or is the work route or location where the work must be performed controlled by the business/employer?

14. **Sequence.** Is the worker dictated to as to the order in which services are performed?

15. **Reports.** Must the worker provide reports accounting for his/her actions on a job?

16. **Pay Schedules.** Is the worker paid by the hour, week or month?
    Are Federal and State taxes withheld from the worker's paycheck?
    Is a W-2 or Form 1099 issued to the worker?

17. **Expenses.** Does the worker pay for his/her own business or travel costs?

18. **Tools and materials.** Is the worker provided with the equipment, tools or materials needed to perform the job/work?

19. **Right to terminate (fire).** Can the worker be terminated without violating a contract?

20. **Worker's right to quit.** Can the worker quit at any time, without incurring liability or violating a contract?

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INDIVIDUAL INCOME TAX (FORM IL-1040)

New 9/2014 Revised through 9/2019

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I. PURPOSE

The purpose of this chapter is to provide general information necessary for the auditing of an Individual Income Tax return (Form IL-1040).

II. REFERENCE SOURCES

A. ILLINOIS INCOME TAX ACT

- IITA § 201
- IITA § 202
- IITA § 203(a)
- IITA § 204
- IITA § 207
- IITA § 208
- IITA § 212
- IITA § 301
- IITA § 302
- IITA § 303
- IITA § 304(a)
- IITA § 502(c)
- IITA § 503(a) and (e)
- IITA § 505(a)(2)
- IITA § 601
- IITA § 701(b)
- IITA § 803
- IITA § 804
- IITA § 806
- IITA § 905
- IITA § 909
- IITA § 1001(a)
- IITA § 1002
- IITA § 1003(a)
- IITA § 1005(a)
- IITA § 1006
- IITA § 1501

B. UNIFORM PENALTY AND INTEREST ACT (35 ILCS 735)

- UPIA § 3-2
- UPIA § 3-3
- UPIA § 3-4
- UPIA § 3-5
- UPIA § 3-7
- UPIA § 3-7.5

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- UPIA § 3-8

C. ILLINOIS REGULATIONS

- 86 IAC § 100.2050
- 86 IAC § 100.2110
- 86 IAC § 100.2130
- 86 IAC § 100.2165
- 86 IAC § 100.2180
- 86 IAC § 100.2197
- 86 IAC § 100.2199
- 86 IAC § 100.2410
- 86 IAC § 100.2470
- 86 IAC § 100.3020
- 86 IAC § 100.3320
- 86 IAC § 100.5000
- 86 IAC § 100.5020
- 86 IAC § 100.5040
- 86 IAC § 100.5050
- 86 IAC § 100.7090
- 86 IAC § 100.8000
- 86 IAC § 100.8010
- 86 IAC § 100.9320
- 86 IAC § 100.9400
- 86 IAC § 100.9410
- 86 IAC § 700.400

D. ILLINOIS COMPILED STATUTES

- 5 ILCS 70/1.25

E. DEPARTMENT FORMS

- Form IL-1040, Individual Income Tax Return, and Form IL-1040 Instructions
- Form IL-1040-X, Amended Individual Income Tax Return, and Form IL-1040-X Instructions
- Form IL-2210, Computation of Penalties for Individuals, and Form IL-2210 Instructions
- Form IL-4562, Special Depreciation
- Schedule CR, Credit for Tax Paid to Other States
- Schedule G, Voluntary Charitable Donations
- Schedule ICR, Illinois Credits
- Schedule K-1-P, Partner's or Shareholder's Share of Income, Deductions, Credits, and Recapture
- Schedule K-1-T, Beneficiary's Share of Income and Deductions

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- Schedule M, Other Additions and Subtractions for Individuals, and Sch. M Instructions
- Schedule NR, Nonresident and Part-year resident Computation of Illinois Tax, and Sch. NR Instructions
- Schedule 1299-C, Income Tax Subtractions & Credits, and Sch. 1299-C Instructions
- Schedule 4255, Recapture of Investment Tax Credits

F. DEPARTMENT PUBLICATIONS

- Publication 101, Income Exempt from Tax
- Publication 102, Illinois Filing Requirements for Military Personnel
- Publication 103, Penalties and Interest for Illinois Taxes
- Publication 108, Illinois Property Tax Credit
- Publication 112, Education Expense Credit - General Rules and Requirements for Schools
- Publication 119, Education Expense Credit- General Rules and Requirements for Home Schools
- Publication 120, Retirement Income
- Publication 129, Pass-through Entity Income
- Publication 132, Education Expense Credit- General Rules and Requirements for Parents and Guardians
- Informational Bulletin FY 2009-02, Pass-through Entity Payments

III. GENERAL INFORMATION

Public Act 76-261 established the Illinois Income Tax Act (IITA) effective August 1, 1969. IITA Article 2 Section 201(a) imposes the tax. Individual Income Tax is calculated by multiplying Illinois net income by a flat rate per IITA § 201(b). Tax rates imposed on individual income have varied since the conception of the Illinois Income Tax on August 1, 1969. Rates from prior years to current are represented in the following chart.

Date	Public Act	Years Affected	Tax Rate
August 1, 1969	PA 76-261	8/1/69 to 12/31/82	2.5%
July 1, 1983	PA 83-014	1/1/83 to 6/30/84	3.0% - temporary
September 19, 1985	PA 84-604	7/1/84 to 6/30/89	2.5%
July 5, 1989/ July 1, 1991	PA 86-018/ PA 87-017	7/1/89 to 6/30/91 7/1/91 to 7/1/93	3.0% - temporary/ extended
July 1, 1993	PA 88-089	7/1/93 to 12/31/10	3.0% - permanent
January 13, 2011	PA 96-1496	1/1/11 to 12/31/14 1/1/15 to 12/31/24	5.0% - temporary 3.75% - temporary
July 6, 2017	PA 100-022	1/1/15 to 6/30/17 7/1/17	3.75% 4.95%

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Generally, IIT audits are conducted in-house and are limited scope audits. Many IIT audits are:

- selected as a result of audits performed on pass-through entities, either for compliance or adjustments to pass-through income, credits, and deductions.
- based around the major issue of residency. Some audits are selected because a compliance check on the pass-through entity suggests that a "nonresident" partner of the entity may actually be a resident and need to file appropriately.
- selected for audit because of special projects, such as "high net earners".
- referred by Sales Tax.
- referred by the Individual Processing Division, the most common being nonresident taxpayers claiming a federal net operating loss.

Throughout the chapter this "bullet style" has been used to indicate when an Exhibit should be reviewed at the end of the chapter. Exhibits have been hyperlinked.

IV. APE SPECIFIC LAW APPLICATIONS

A. RETURN DUE DATE

The annual Individual Income Tax return (Form IL-1040) is required to be filed on or before the 15th day of the fourth month following the close of the taxable year. Ref: IITA § 505(a)(2) and 86 IAC § 100.5000(a)(1). For calendar year filers, the due date will be April 15. For audit purposes, the federal Form 1040 and Form IL-1040 must be compared and verified as to the filing of either calendar year or fiscal year ending.

- 86 IAC § 100.5000(e)(4) provides that, if the federal due date for a return has been extended by the IRS because of natural disaster, holiday, etc., no late filing penalty will apply to a taxpayer who files his or her equivalent Illinois return by the extended federal due date. 86 IAC § 100.6000 provides that, if the federal due date for payment is extended by the IRS because of natural disaster, holiday, etc., the due date for payment of the equivalent Illinois tax receives a similar extension.

B. POSTMARK DATE

The general statutory rule is that the postmark date establishes the legal filing date for an item of mail passing through the U.S. Postal Service. Ref: 5 ILCS 70/1.25. If the due date for any return, other report, or payment falls on Saturday, Sunday, or a holiday, filing by the next business day is deemed to be timely for those documents submitted either through mail or in person. Ref: 86 IAC § 100.5000(b).

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[Note – *Rubloff CB Machesney, LLC v. World Novelties, Inc.,* 363 Ill.App.3d 558, 844 N.E.2d 462 (2nd Dist. 2006) held that Section 1.11 of the Statute on Statutes applies only to determining the end of a period (such as the 60-day period to file a protest) and not when the due date is a specific date. 86 IAC § 100.5000(b) has been amended to delete the provision based on the Statute on Statutes and to piggyback on the IRC, which deems filing by the next business day to be timely, rather than changing the due date~~)~~. This difference in rules has no effect on timeliness of a return filed on April 17 when April 15 is a Saturday but has the consequence that a six-month extension of the filing date will start on April 15, rather than April 17.]

C. EXTENSION FOR FILING

All taxpayers are automatically granted an extension of six months (seven months for corporations) to file their Illinois income tax return (except the IL-941) without requesting it or submitting an application for extension. Ref: IITA § 505(a)(2) and 86 IAC § 100.5020(b).

- This directly impacts the way the statute of limitation dates are calculated for the issuance of a Notice of Deficiency or the filing of a claim for refund. For purposes of issuing a Notice of Deficiency or filing a Claim for Refund, the time a return is deemed filed, if filed before the extended due date, is the last day of the automatic extension period. Ref: 86 IAC §§ 100.9320(h) and 100.9410(e).

Note: An extension to file a return does not grant an extension to pay if a tax liability exists. Ref: 86 IAC § 100.5020(a).

D. PAYMENT DATE FOR TAX OWED

Payment for tax owed is required on the original return due date of April 15 or the next business day if the 15th falls on a weekend or holiday for calendar year filers. Fiscal filers would pay on the 15th day of the fourth month following the close of their taxable year.

- If the taxpayer decides to utilize the automatic extension, payment of the tax owed must be submitted with Form IL-505-I, Automatic Extension Payment for Individuals, by the original filing due date in order to avoid penalty and interest on tax not paid timely. Ref: IITA § 602(a) and (b).

E. STATUTE DATES

For audit purposes, knowing the correct due date of a return is important when determining the statute of limitations. Due dates and extensions generally affect the statute of limitations for issuing a Notice and Demand, Notice of Deficiency, or the filing of a claim for refund, and the filing of liens.

Refer to Chapter 21 for additional information on statute dates.

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F. EXTENSION OF STATUTE OF LIMITATIONS

The statute of limitation date should be identified at the beginning of an audit and is crucial so that the audit may be successfully completed and processed before the statute closes. Extending the statute of limitations by waiver (Form IL-872) is a vital part of proper audit procedures.

Form IL-872 is normally used to extend the statute of limitation for the issuance of a Notice of Deficiency for a year or years involved in an audit. Under IITA § 905(f), a Notice of Deficiency may be issued at any time prior to the expiration of the period agreed upon on Form IL-872. Both the taxpayer and the Department, prior to the expiration of the previous statute of limitation, must execute the extension.

Per IITA § 905(f), the IL-872 and ICB-1 are both viable vehicles to honor this statute for extension.

905(f) Extension by agreement. Where, before the expiration of the time prescribed in this section for the issuance of a notice of deficiency, both the Department and the taxpayer shall have consented in writing to its issuance after such time, such notice may be issued at any time prior to the expiration of the period agreed upon. In the case of a taxpayer who is a partnership, Subchapter S corporation, or trust and who enters into an agreement with the Department pursuant to this subsection on or after January 1, 2003, a notice of deficiency may be issued to the partners, shareholders, or beneficiaries of the taxpayer at any time prior to the expiration of the period agreed upon. Any proposed assessment set forth in the notice, however, shall be limited to the amount of any deficiency resulting under this Act from recomputation of items of income, deduction, credits, or other amounts of the taxpayer that are taken into account by the partner, shareholder, or beneficiary in computing its liability under this Act. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

V. FILER GUIDELINES

A. ILLINOIS RESIDENT

The determination of whether or not an individual is a “resident” of the state of Illinois is important because a resident is taxed on all (100%) of his income, even if it is derived from sources outside of Illinois. If other states are entitled to tax some of the income of an Illinois resident, then that individual may file Schedule CR, Credit for Tax Paid to Other States (discussed later in this chapter).

An Illinois resident must file a Form IL-1040 if:

1) They are required to file a federal income tax return; or

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2) They are not required to file a federal return, but Illinois base income on Form IL-1040 is greater than the Illinois exemption allowed.

1. RESIDENCY

Residency can be a complex audit issue, especially in light of the Tyler Cain court case decision [2012 IL App (1st) 112833]. See Audit Manual Chapter 49, Court Cases, for information on residency issues.

The following help to define or explain terms concerning "residency":

a. IITA § 1501(a)(20) defines the term "resident". Also see 86 IAC § 100.3020(i).

b. 86 IAC § 100.3020(b) explains residency pertaining to individuals.

c. 86 IAC § 100.3020(c) examines "temporary or transitory" through examples.

Determining Residency

Determining residency requires thorough analysis when the taxpayer has multiple residences, personal accounts, and spends time between different states. The auditor's job is to determine the taxpayer's state of residency.

- An auditor can request any relevant evidence to help determine residency. The amount and type of substantiating documentation will be unique to each situation.

    - Some types of supporting evidence may be (but not limited to):
        - voter registration
        - automobile or driver's license
        - filing status for other states' tax returns
        - home ownership/rental agreements
        - telephone/utility usage over a period of time
        - organizational membership.

- Taxpayers will often try to claim residency in a state where their tax obligation is lower.

  Example: Issue is stock options. An Illinois resident worked for an Illinois company. After he retired he moved to Florida and cashed out his stock options in the company. The company gave the former employee a W2-C allocating all of the stock option distribution to Florida and none to Illinois.

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- Qualified employee benefit plans, including 401(k) plans, are not taxed by Illinois under IITA § 301(c)(2). A qualified employee benefit plan is defined in IRC §§ 402 through 408. If a plan is qualified, the employee's W-2 will have the code for a qualified retirement plan.

- Federal law P.L. 104-95 (4 USC 114) limits the power of states to impose income taxation on certain nonresident pension income for amounts received after December 31, 1995. This limitation also impacts income received by a nonresident in the form of distributions from many deferred compensation plans. For example, a deferred compensation plan paid out over at least 10 years is a non-qualified plan under IITA § 301(c)(2) but Illinois cannot tax the distributions per P.L. 104-95. IAC § 100.3120(b)(1).

- The allocation of distributions to nonresidents which are not covered under P.L. 104-95, including severance pay and stock options, are governed by IAC §100.3120(b)(1). Where compensation is paid to a nonresident for past service, such compensation will be presumed to have been earned ratably over the employee's last 5 years of service with the employer. Severance and stock options earned over the last 5 years of employment are taxed based on the residency over the last 5 years. If the taxpayer worked in Illinois the last 5 years, no matter where they move, the severance and stock options are taxable to Illinois. If they moved for 3 years and were in Illinois for 2 years, the payout is allocated appropriately. Residency at payout is not a factor.

- Some taxpayers will file "zero" returns with Illinois to start the Statute of Limitations.

See 86 IAC § 100.3020(f) – presumption of residence, and 100.3020(g) – proof of residence or nonresidence for guidance.

2. DOMICILE

Closely tied to residency is domicile. Domicile is the other important factor in determining whether an individual is a resident or nonresident of Illinois. See 86 IAC § 100.3020(d) for an in-depth definition of "domicile".

- Military personnel will continue to be domiciled in Illinois even if their assignment to duty is in other states for long periods of time. Ref: 86 IAC § 100.3020(h).

- Often, individuals who leave Illinois during winter months ("snow birds"), students studying out-of-state, individuals working in a foreign nation, and military

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personnel stationed out-of-state incorrectly file as part-year or nonresidents. These are generally temporary absences, where their domicile remains in Illinois and they have not abandoned it and intend to return.

- The instructions to Form IL-1040 state:

  You are an Illinois resident if you were domiciled in Illinois for the entire tax year. Your domicile is the place where you reside and the place where you intend to return after temporary absences. Temporary absences may include duty in the U.S. Armed Forces, residence in a foreign country, out-of-state residence as a student, or out-of-state residence during the winter or summer.

- A taxpayer, regardless of the number of homes owned, may only have one domicile. This is the place that the taxpayer ultimately considers "home" and to which he or she intends to return.

  - A taxpayer loses his Illinois domicile by:

    1) locating elsewhere with the intention of establishing the new location as his domicile and
    2) abandoning any intention to return to Illinois.

a) Thomas E Brew, Jr. v. Commissioner of Revenue

The Massachusetts court case, Thomas E Brew, Jr. v. Commissioner of Revenue (8/24/10), is illustrative of what auditors may encounter concerning domicile. An excerpt follows:

> The taxpayer (petitioner) had maintained his domicile in Massachusetts for many years, with only a short stay in Washington, D. C. working for the IRS. He was offered a job with Florida and accepted, with the idea that he would commute for a while and eventually relocate with his family. The family had owned rental property in Florida but sold it except for a condominium where the taxpayer stayed while in Florida. His employer agreed to allow him to commute until his child graduated from high school. He stayed in his minimally furnished condominium while in Florida and returned on average every other weekend and holidays to Massachusetts.
>
> There was detailed information on his social life in Massachusetts, but little in Florida. He had a Florida driver's license and had registered there to vote but conducted most financial matters from and listed his primary address as Massachusetts. A critical piece of the case was that the couple expanded one of their Massachusetts homes and the taxpayer

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waived relocation benefits to continue to receive travel reimbursement.

Noting that a domicile, once established, continues until abandoned (and a new one acquired), the board determined that the taxpayer did not intend to abandon his Massachusetts domicile, and was domiciled in Massachusetts, not Florida.

This decision is consistent with a longstanding legal position concerning domicile in Illinois from an Illinois Supreme Court decision, Holt v. Hendee (1911):

> [I]n order to effect a change of domicile, there must be an actual abandonment of the first domicile coupled with an intention not to return to it, and there must be a new domicile acquired by actual residence within another jurisdiction coupled with the intention of making the last acquired residence a permanent home. In order to bring about a change of residence, it is necessary that there be not only an intention to change the residence, but the change must actually be made by abandoning the old and permanently locating in the new place of residence.

In addition to court cases (see Audit Manual Chapter 49), there are also many Administrative Hearing decisions, General Information Letters, and Private Letter Rulings concerning residency questions (e.g. IT 10-02, IT 09-08, 09-0042-GIL, 08-0026-GIL) available at http://tax.illinois.gov/LegalInformation/index.htm.

b) How to Determine a Taxpayer did not Abandon Their Domicile

Overseas/Foreign Employment: at issue is when a taxpayer is either a non-filer or files as a nonresident. Auditor needs to ask the taxpayer for:

- A copy of their employer's General Employment Policy (agreement) covering extended overseas/foreign employment (exceeding one year). Items that the auditor may need to look for in the "agreement":
  - The employer (company) does not help the employee establish foreign residency
  - The employer (company) tells the employee to retain their home residency in Illinois
  - The employer (company) strongly encourages the employee not to sell their home due to tax consequences (capital gains)
  - The employer (company) strongly encourages the employee to take vacations back to the US (Illinois) to maintain a balanced life
  - The employer (company) strongly encourages the employee not to purchase a home in the foreign country

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- A copy of the Letter of Understanding (contract) for that taxpayer.

Taxpayers with employment contracts with a specified return date or contract time (3 years, or 18 months, etc.) are Illinois residents. The contract is written for them to return. If the employment contract is open ended or undetermined, the taxpayer can be considered a nonresident of Illinois. Additionally, if the employee is overseas and their company has no intent for them to return, the company does not have to withhold Illinois income tax.

Taxpayers claiming the homestead exemption on their Illinois residence intend to return and are residents.

When assignment time and residency is in question, the auditor can ask for the employment contract, residency questionnaire, and questions such as:

- ✓ Did your family go with you?
- ✓ Did you sell your house or rent it out?
- ✓ If the APE is later than 2013, is the Illinois property owner claiming the homestead exemption?
- ✓ Are they returning to the same employer when they come/came back from overseas?

Note: There appears to be an ongoing issue with some major Illinois companies that have employees that they send overseas. The companies are issuing Illinois W-2s, and when the employee files taxes and wants their withholding back, the company is issuing a corrected W-2. Since many of these taxpayers are Illinois residents, each case should be reviewed to make a residency determination concerning the withholding.

Example #1: The taxpayer was on a 2-3-year assignment in another country. The taxpayer kept their home in Illinois and planned to return. Their company withheld Illinois income (WIT), and the taxpayer is trying to get it refunded back.

Determination was that the taxpayer is an Illinois resident based on (1) their employment contract with a specified contract time, and (2) the fact that they claimed the Illinois homestead exemption on their home. The Illinois tax withheld should not be refunded.

Example #2: Grede Court Case from DuPage County [2013 ILApp(2d) 120731-U] – the taxpayer's original contract was for 2 years in Singapore. There was incentive for that person to stay longer overseas. The judge decided it was an ongoing overseas employment and that the person was a nonresident.

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Example #3: The taxpayer worked overseas with an original contract of 18 months, extended 5 more months, then returned to the US (Illinois) working for the same company. He did not sell his house and claimed the Illinois homestead exemption. The taxpayer is not contesting domicile but is contesting residency. It appears that this taxpayer would be considered an Illinois resident.

3. VETERANS BENEFITS AND TRANSITION ACT OF 2018

The federal Veterans Benefits and Transition Act (VBTA) of 2018 expanded upon the protections originally extended by the Military Spouses Residency Relief Act to spouses of military member's effective beginning with the 2009 tax year. The Veterans Benefits and Transition Act of 2018 took effect for tax year 2018. Under this act, the state of residence of a military member's spouse does not change when the spouse accompanies the service member to a military assignment located in another state. Beginning in the tax year 2018, the spouse is also allowed to elect to use the same residence as the military member for purposes of taxation. The election is applicable to the entire tax year of the marriage. An exception would be if both the service member and spouse choose to establish residency in another state.

This legislation provides that the spouse's employee wages will be taxable only by the state of residency rather than by the state in which the service member and spouse are stationed. For this legislation to apply:

- The spouse's income (wages) must be earned in the same state where the couple is being stationed; but
- In the case of a spouse who has elected to use the same residence as the military member for tax purposes, the spouse's income (wages) are not required to be earned in the same state where the service member is stationed.
- The spouse and service member must share the same state of residency.

Example: Captain John Doe and his wife, Jane, are residents of Illinois. When John received military orders to be stationed in North Carolina in 2009, Jane moved with him. Once in North Carolina, Jane started a part-time job at the local pizza parlor in March (2009). Per this new legislation, Jane's wages earned in North Carolina should be taxable by Illinois, not by North Carolina. For tax year 2009, Jane would need to file an income tax return with North Carolina requesting a refund, and then also file an income tax return with Illinois showing the income that she made in North Carolina in order to pay any tax due to Illinois.

Example: Private Jane Doe is a resident of Florida. Jane received orders to be stationed in Illinois in 2016. In April of 2018, Jane marries John, an Illinois resident and college student who works part time for a shipping company. After the wedding, for tax purposes, John elects to use Jane's Florida residency. In

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November, Jane receives orders to be stationed in Minnesota. John remains in Illinois to finish school. For tax year 2018, John would not file an income tax return in Illinois for the income he made within Illinois because it is only taxable in Florida.

Service Income:
50 US Code 4001 Part C states: **Income of a military spouse**: Income for services performed by the spouse of a servicemember shall not be deemed to be income for services performed or from sources within a tax jurisdiction of the United States if the spouse is not a resident or domiciliary of the jurisdiction in which the income is earned because the spouse is in the jurisdiction solely to be with the servicemember serving in compliance with military orders.

The Code states income, which includes but is not limited to compensation, for services performed is not taxable. However, if the income is for anything else other than services performed, it is should be taxable.

Example: The spouse of a military service member assigned to Scott AFB is an independent contractor who received compensation for services performed during the year as a home caregiver. This is reported on a 1099-MISC. This would be deductible because the spouse was only in IL as the spouse of military personnel stationed at Scott AFB.

However, if the spouse received a 1099-MISC that reported royalty income (these royalties constitute IL income under IITA § 303), this would be taxable because this has nothing to do with the military assignment and the fact that the spouse was in IL.

a) Schedule MR- Military Spouse Relief

The form Schedule MR, Military Spouse Relief, should be completed and attached to the 2009 Form IL-1040, Individual Income Tax return. Schedule MR was only used for the 2009 tax season.

For nonresidents who are stationed with their military spouse in Illinois, box 1 on the Schedule MR should be checked. The two-letter abbreviation for the couple's state of residency must also be entered.

For residents of Illinois who are stationed with their military spouse in another state, box 2 on the Schedule MR should be checked. When filing a 2009 Form IL-1040 paper return, the taxpayer should write "Military Spouse" in red ink across the top of the Form IL-1040 front page.

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b) Form IL-W-5-NR- Employee's Statement of Non-Residence in Illinois

In order for non-residents to receive exemption from Illinois withholding under the Veterans Benefits and Transition Act of 2018 or the Military Spouses Residency Relief Act, the affected spouse must complete Form IL-W-5-NR and file this form with his or her Illinois employer.

For more information concerning Military Personnel, see Publication 102, Illinois Filing Requirements for Military Personnel, at: http://tax.illinois.gov/Publications/Pubs/Pub-102.pdf

B. RECIPROCAL STATE AGREEMENTS

Illinois has a reciprocal agreement with Iowa, Kentucky, Michigan, and Wisconsin in which these states do not tax the compensation paid to Illinois residents that work in these states per IITA § 701 and 86 IAC § 100.7090.

Illinois residents who work in Iowa, Kentucky, Michigan, or Wisconsin must file the Form IL-1040, as the compensation paid by employers in those states is taxed by the State of Illinois. Note that if the employer withheld state tax from compensation within any of the reciprocal states in error, the Illinois resident should file the correct W-2 form with that state to claim a refund. Tax withheld erroneously by other states cannot be used as a credit on the Illinois return.

Example: Bill Smith is an Illinois resident, but works for a company in Madison, Wisconsin. Since his employer is aware of the reciprocal state agreement, tax on compensation is correctly withheld as taxed by Illinois and not Wisconsin. John should therefore file the Form IL-1040 with his home state of Illinois.

Residents of Iowa, Kentucky, Michigan, or Wisconsin who work in Illinois must file Form IL-1040 and Schedule NR if:

- Income was received in Illinois from sources other than wages, salaries, tips, and commissions; OR
- A refund is desired on any Illinois Income Tax withheld in error.

Example: Ann Jones is a resident of Iowa, but in January of 2009, she started working for a company in Rock Island, Illinois. Unfortunately, her new employer was not aware of the reciprocal state agreement and had erroneously withheld Illinois tax on Ann's wages in 2009. For that tax year, Ann would need to file Form IL-1040 and Schedule NR for a refund of the Illinois tax withheld.

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Based on the reciprocal state agreements, employers in Illinois should not withhold Illinois taxes on these reciprocal state residents per IITA § 302(b). The employees would need to file Form IL-W-5-NR, Employee's Statement of Non-residence in Illinois, with their employer to be exempt from the Illinois Income Tax withholding.

Withholding Issues

It is common for residents of states with reciprocal agreements with Illinois to not complete a Form IL-W-5-NR, or to claim that the employer would only withhold to Illinois. This leads to the taxpayer being taxed on Illinois earnings in their home state without the proper withholding in their resident state.

- Processing requires that the nonresident file an Illinois return with a Schedule NR to get a refund of that withholding.
- An auditor would want to verify that the taxpayer truly is a resident of that reciprocal state, and should request relevant information to substantiate that, such as copies of the Form W-2, resident state tax return, and driver's license.

C. PART-YEAR RESIDENT

The definition for "part-year resident" can be found in IITA § 1501(a)(17). Part-year residency only applies to taxpayers who have moved into Illinois and established domicile during the current tax year or moved out of Illinois and established domicile in another state during the current tax year, and not for temporary or transitory purposes.

Taxpayers often claim to be part-year residents when they are full-year residents. They assume that their absence from Illinois for a period of time classifies them as part-year residents, and they allocate less income to Illinois.

> Example: Some retired taxpayers who spend part of the year in Florida ("snow birds") will file every year as part-year residents. They should actually file as full-year residents every year, because their domicile has not changed, and they are gone for only temporary or transitory purposes and intend to return.

Auditors should always verify the residency status of a taxpayer. One red flag for residency would be noting many consecutive years where the taxpayer has filed as a part-year resident, since abandoning and establishing a new domicile yearly would be unlikely. After a legitimate change in domicile has occurred, it is fair to question residency if it continues to be part-year in subsequent tax years.

Part-year residents must file Form IL-1040 and Schedule NR if:

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- Income was earned from any source while an Illinois resident;
- Income from Illinois was earned when not a resident; or
- A refund is desired from any Illinois Income Tax withheld.

As a part-year resident, the rules used to determine Illinois income and tax depend on whether or not the person was an Illinois resident when the income was earned.

- If the person was an Illinois resident when the income was received, 100 percent of the income will be taxed (within certain limitations), regardless of the source of that income.
- If the person was a nonresident when the income was received, only the income received from Illinois sources will be taxed.

D. NONRESIDENTS

Nonresidents must file Form IL-1040 if:

- Enough taxable income was earned from Illinois sources to have a tax liability (i.e., the taxpayer's Illinois base income from Schedule NR is greater than their Illinois exemption allowance on Schedule NR); or
- A refund is desired for any Illinois Income Tax withheld in error.

E. NONRESIDENT ALIEN

Nonresident aliens must file Form IL-1040 if income is taxed under federal income tax law.

U.S. 1040NR or U.S. 1040NR-EZ

When filing Form IL-1040, a completed copy of either the federal Form 1040NR, U.S. Nonresident Alien Income Tax Return, or federal Form 1040NR-EZ, U.S. Income Tax Return for Certain Nonresident Aliens with No Dependents, must be attached.

- Returns are due the 15th day of the fourth month after the end of the tax year. For calendar year filers, the due date is April 15th.

- If a nonresident is exempt from income tax and had withholding from wages, he must file a Form IL-1040 and Schedule NR and provide a copy of his complete federal return and tax treaty indicating exempt status to receive a refund of Illinois withholding. Standard Individual Income Tax (IIT) processing procedure will adjust the return and tax the nonresident alien on Illinois W-2 wages and notify him of the adjustment and the support required if he is exempt and wants a refund of withholding.

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F. NONRESIDENT PROFESSIONAL ATHLETES

Compensation paid to nonresident professional athletes is covered under IITA § 304(a)(2)(B)(iv), in which "duty days" are utilized in determining the Illinois portion of the total compensation for services performed. Per IITA § 304(a)(2)(B)(iv)(c)(3), the term "duty days" means all days during the taxable year from the beginning of the professional athletic team's official pre-season training period through the last game in which the team competes or is scheduled to compete (except as provided in items (C) and (D) of this same subpart).

The proper calculation of duty days is important in determining the amount of income allocable to Illinois. The number of duty days spent within this State (Illinois) is divided by the total number of duty days spent both within and without this State. This percentage will then be multiplied by the taxpayer's total compensation to determine the portion attributable to Illinois. (Ref: IT 07-0029-GIL).

> Example: Joe Ballplayer is a catcher for a Major League Baseball Team located in Illinois. In order to determine the portion of his total compensation to be allocated to Illinois for the 2016 tax year, the following information should be taken into account to determine Illinois duty days and Total duty days. Preseason training camp, which is 45 days long, is always held in Arizona and will be included in the total duty days. Any post season games must also be accounted for, if played. The team that Joe plays for did not make the playoffs in 2016.
>
> The total duty days, including the 45 training camp days, was 230. The Illinois duty days ("the number of duty days spent within this State, performing services for the team") was 125. Joe's total compensation for 2016 was $2,642,354. To calculate the Illinois portion, the number of Illinois duty days is divided by the number of total duty days (125/230 = 54.35%). This percentage is then multiplied by the total compensation to determine the Illinois portion (54.35% X $2,642,354 = $1,436,119.) $1,436,119 would be allocated to Illinois.

Total Duty Days	Illinois Duty Days	Total Yearly Compensation	Illinois Portion Percentage	Illinois Portion of Compensation
230	125	$2,642,354	125/230 = 54.35%	54.35% X $2,642,354 = $1,436,119

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VI. PERSONAL INFORMATION

A. SOCIAL SECURITY NUMBER

The Social Security numbers (SSNs) must be provided in the order in which they appeared on the federal return. Both filer and spouse SSNs are required even if married filing separate returns. Note that if a taxpayer does not qualify for a SSN and was issued an Individual Taxpayer Identification Number (ITIN) by the IRS, this number should be used in place of the SSN.

If a taxpayer is not registered in GenTax, or the SSN appears to be "invalid" (was not verified by the IRS), a temporary SSN can be assigned in GenTax.

When tracking taxpayer information in GenTax, all married filing jointly and married filing separately taxpayers are linked in GenTax. A link is a reference between two taxpayer records that indicates that the two taxpayers have some type of relationship, such as husband and wife. Payments must be verified under both taxpayers' SSNs utilizing this link.

Taxpayers who do not have a valid SSN are eligible to obtain an Individual Tax Identification Number (ITIN) from the IRS and file using that number. This can be obtained by filing a federal Form W-7. These numbers commonly begin with the number "9" for individuals. Groups that are required to file a federal tax return but are ineligible to obtain an SSN must obtain an ITIN, and then file with that number. If the taxpayer happens to be an illegal alien, he may continue to work under a false name and SSN and continue to receive W-2s under the false identity. Nevertheless, the taxpayer is expected to file federally and with Illinois under the ITIN and name associated with the ITIN. For more information concerning ITINs, visit http://www.irs.gov/ and search "Forms and Publications" for Form W-7.

Note: Per confidentiality guidelines, all "manual" correspondence distributed by the Department should be in the "XXX-XX-1234" format in order to protect the taxpayer's personal information.

B. NAME AND ADDRESS

If married and filing a joint Form IL-1040 return, the names must appear in the order as filed on the federal return. If married and filing separate returns for Illinois tax purposes, the taxpayer's name and the spouse's name are both required on both IL-1040 forms.

Name, address, zip code, and social security numbers provided on the Form IL-1040 should be compared to the federal return for audit purposes. Any discrepancies should be verified by the taxpayer and the corrected information detailed in the audit report.

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C. FILING STATUS

Filing status for the Form IL-1040 may be any of the following:

1) Single or head of household
2) Married filing jointly
3) Married filing separately
4) Widowed

In general, the same filing status that was checked on the federal return should be used on the Form IL-1040 per IITA § 502(c)(1). An exception to this rule is when a joint federal return is filed, and one spouse is a full-year Illinois resident and the other is a part-year resident or a nonresident (e.g., military personnel). Such a couple may choose to file "married filing separately" for Illinois purposes as provided in IITA § 502(c)(3).

Civil Unions

Beginning with the 2011 tax year, a check box was added to the Form IL-1040 for couples in Civil Unions. Complete details for proper return filing are included in the Form IL-1040 instructions, which should be referenced for years 2011 through 2013.

- For tax year 2011, the taxpayer had to file the Form IL-1040 return on paper, rather than electronically.
- For tax years 2012 and 2013, the Form IL-1040 can be filed electronically. Also, for these tax years, Schedule CU, Civil Union Income Report, must be completed and included with the Form IL-1040 when filed.
- For tax years 2014 and forward, the check box and Schedule CU were eliminated. All taxpayers are required to follow the filing status on the federal return.

Public Act 98-0597 (Same-Sex Marriage)

Passage of PA 98-0597 created the Religious Freedom and Marriage Fairness Act, allowing for same-sex marriages. The effective date of this legislation is June 1, 2014. This Act provides for newly instituted same-sex marriages and for conversions of existing civil unions (as of that date) into marriages.

1. INJURED SPOUSE

An injured spouse is a person who could request tax relief when that person was not responsible for the outstanding debt of the other spouse. Outstanding debt could

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include: past due federal or state income tax, child support, spousal support, or certain federal debts such as student loans.

> Example: John and Jane were married in 2008. The couple both worked for a manufacturing company as accountants. When they filed their joint state income tax return the next spring expecting a refund, the entire refund amount was taken to cover John's unpaid child support from previous years. Since Jane was not responsible for her husband's outstanding debt, she applied for injured spouse relief to recover her portion of the 2008 tax refund.

For taxable years ending on or after December 31, 2009, if a joint federal income tax return is filed and there is an injured spouse, separate Illinois returns should be filed using "married filing separately" as the filing status. This election to file separately must be made on or before the return due date (including extensions) and once made is irrevocable for the tax year. If a joint Illinois return is filed, the entire refund may be used to pay the outstanding liability owed by the other spouse.

Civil Unions would be treated the same for Injured Spouse purposes. If one taxpayer has obligations subject to offset (i.e. child support, tax debt, unemployment, etc.) they would need to file separate returns upfront, so that the injured spouse's portion of the refund isn't offset. If they file a joint return and the refund is offset to any other agency besides Revenue, they would have to deal with that agency to recover the offset refund.

For taxable years prior to December 31, 2009, the injured spouse needed to comply with the following injured spouse relief requirements.

Injured spouse relief could be applied for if:

1) The taxpayer had filed a joint Form IL-1040 with the spouse for a tax year;
2) The other spouse had unpaid debt which the injured spouse is not legally obligated to pay; and
3) All or a portion of the joint Illinois Individual Income Tax overpayment (refund) may be used to offset the spouse's unpaid debt.

- To apply for injured spouse relief for the years prior to December 31, 2009, no special form is provided by the State of Illinois. The injured spouse must file an original Form IL-1040 using the "married filing jointly" filing status and write "Injured Spouse" in red ink across the top of the front page of the Form IL-1040.
    - If injured spouse relief was applied for with the Internal Revenue Service (IRS) using federal Form 8379, Injured Spouse Allocation, a copy of that form must be attached to the Form IL-1040.

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- If a joint Illinois return was already filed, and all or a portion of the refund is being offset to satisfy the spouse's unpaid debt, the injured spouse may request a refund of his or her portion of the overpayment by filing Form IL-1040-X, Amended Individual Income Tax return. The injured spouse must show the separate tax liability on the Amended return and write "Injured Spouse" in red ink across the top of the front page.
    - Also required to be attached are: a copy of the joint federal tax return, any W-2 and 1099 forms, and federal Form 8379 (if filed).

2. INNOCENT SPOUSE

Spouses may be entitled to relief from some or all liability of a joint Form IL-1040 return under the Innocent Spouse provision in IITA § 502(c)(4) and 86 IAC § 100.5040. Innocent spouse relief may be requested when a spouse believes that the sole responsibility for paying the tax liability on a joint Form IL-1040 falls on the other spouse.

> Example: During their marriage, Bill was a vice president in a local mining company and his wife, Sue, stayed at home to raise their three children. In 2011 the mining company determined that Bill had been embezzling money from the company during the past two years, 2009 and 2010. This information was turned over to the IRS, which assessed deficiencies against the couple based on the embezzled figures determined by the mining company. For 2009, this amount increased the couple's income by $60,000, and for 2010, by $50,000. Based on this information provided by the IRS, the IDOR also assessed deficiencies for the two years, showing this increase in base income. Since Sue was unaware of her husband's illegal activity, she applied for innocent spouse relief from the entire assessed liability (both federal and state). Ref: IT 01-0004-GIL.

Innocent spouse relief may be applied for if:

1) A joint return was filed with your spouse for a tax year;
2) At the time the return was signed, the innocent spouse was unaware that the other spouse had omitted income, claimed false deductions or credits, or otherwise had prepared an erroneous return; and
3) The innocent spouse believes that the tax liability was the other spouse's sole responsibility.

Starting in tax year 2000, Illinois required the new Form IL-8857, Request for Innocent Spouse Relief, to be completed when applying for innocent spouse relief. To apply for this relief, Form IL-8857, Request for Innocent Spouse Relief, must be completed for each year that relief is being requested.

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In addition to IL-8857, the following forms (if applicable) must be provided:

a) A copy of the original federal and Illinois income tax returns;
b) A copy of any amended federal and Illinois income tax returns;
c) A copy of federal Form 8857, Request for Innocent Spouse Relief, if filed with the IRS;
d) Any final determination of the federal or Illinois tax liability that was received from the IRS, Illinois Department of Revenue, or a court of law, including any grant or denial of innocent spouse relief; and
e) Any other supporting documentation that would be helpful in determining eligibility for innocent spouse relief.

There is no time limit for making an innocent spouse claim. However, a refund will only be issued for a tax year if: Form IL-8857 is received within three years after the extended due date of the original Form IL-1040, or three years after the date the original Form IL-1040 was filed, or one year after the Illinois tax was paid, whichever is latest.

VII. FEDERAL INCOME

A. ADJUSTED GROSS INCOME (AGI)

The starting point for determining Illinois personal income tax for resident individuals, nonresident individuals, and part-year residents is federal Adjusted Gross Income (AGI).

LINE 1 ADJUSTMENTS DURING AN AUDIT

During the audit process, an auditor may make the determination that adjustments are necessary to the reported IL-1040 Line 1 figure – Adjusted Gross Income (AGI).

Current audit policy dictates that auditors **must** submit a request for Illinois Line 1 change approval. This approval must be submitted through the auditor's supervisor, who will then forward the request to the appropriate ADM (field) or DM (in-house). Appropriate supporting documentation must be provided with the Line 1 adjustment request at the time of submission.

When submitting such a request, proper statute control procedures **must** be followed. Submission of a Line 1 change request needs to be made as early as possible in the audit. If needed, a properly executed IL-872 needs to be on file to support the time required for approval. Reminder: Per Management Expectations, audits are required to be sent to Audit Review with a minimum of four months left on the statute.

Audit changes made based on the federal tape match information are not affected by this new policy. Also, not at issue would be when auditors question federal items that

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only affect the Illinois items outside of Line 1, such as modifications, apportionment, and credits.

1) The Form IL-1040 Line 1 amount should reconcile to the federal AGI. Any variance in these figures must be researched and explained in the audit report.

    - The auditor should always vouch and verify the AGI reported on the Form IL-1040 with the taxpayer's federal return, regardless of any suspicion of an incorrectly reported AGI. This is critical, since the correctness of tax liability assessed per return or audit depends on the correctness of what is reported on Form IL-1040 Line 1.

2) Only "properly reportable" AGI can be accepted. This may be challenged by an auditor, even if Form IL-1040 Line 1 is the same AGI that was reported federally. See IITA § 203(e)(1).

    The taxpayer may assert (especially in individual audits) that the auditor cannot audit "above" the AGI, that is, the federal income and deductions that lead to the federal AGI. Taxpayers often have a misconception that only the IRS can change federal items, including the AGI, and that the auditor must start with AGI, with a scope limited to state items. However, audit policy now dictates that the approval process as stated above must be followed before any Line 1 adjustments are made.

3) Additionally, if there is a change necessary, but the IRS decided not to act, it does not mean the Department is barred from correcting the return. However, audit policy now dictates that the approval process as stated above must be followed before any Line 1 adjustments are made.

    Example: An individual had sold her lottery winnings and reported it incorrectly to the IRS. The taxpayer's attitude was "well, if the IRS did not change it, then you (IDOR auditor) cannot. ICB concurred that even if the IRS decided not to pursue (collectability, etc.), IDOR auditor could still make changes to correct the return.

4) If an IRS transcript needs to be requested, the taxpayer is able to access account information and get a transcript almost instantly on line. If the auditor does not want to wait through the Department's regular Fed/State disclosure channels, the auditor should present this option to the taxpayer (if that taxpayer is cooperating with the auditor).

B. FEDERAL NET OPERATING LOSS (NOL), Individuals

Note: The following sections on federal/Illinois losses are based on 86 IAC § 100.2410 that became effective on January 12, 2004, although this legislation was retroactive for all tax years.

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A taxpayer (individual) may report a Federal NOL occurring that year on Line 1 of the Form IL-1040, and this figure must be shown as a negative amount. However, this amount must be reduced by any NOL that is carried back to prior years.

Generally, for federal income tax purposes, individuals must carry back an NOL 2 years, then carry forward the remaining NOL for up to 20 years.

- Taxpayers may make an election to forego the carry back and just carry forward the loss 20 years as long as the election is made by the extended due date of the return.

- The Federal Job Creation and Worker Assistance Act of 2002 temporarily changed the carry back from 2 years to 5 years for NOL's in tax years 2001 or 2002. Individuals qualified for the benefit of this 5 year carry back since they are allowed to take the federal NOL deduction in computing their Illinois net income.

1. FEDERAL FORM 1045 AND FORM 1040-X

For federal purposes, taxpayers may carry back an NOL by using either Form 1045 or Form 1040-X.

Note: Federal Form 1045 is used by an individual, estate, or trust to apply for a quick tax refund resulting from the carryback of an NOL, the carryback of an unused general business credit, the carryback of a net Section 1256 contracts loss, or an overpayment of tax due to a claim of right adjustment under Section 1341(b)(1).

Form 1045

Form 1045 must be filed within 1 year after the end of the year in which an NOL arose.

Form 1040-X

Taxpayers may file Form 1040-X within 3 years of the due date (or extended due date) of the loss year return.

2. SCHEDULES A AND B OF FEDERAL FORM 1045

Schedule A

Individuals calculate the amount of their federal NOL carrybacks by using Schedule A of federal Form 1045.

Schedule B

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The amount of NOL available to carry to subsequent years is calculated on Schedule B of federal Form 1045 even when a Form 1040-X is used to carry back the loss.

- The amount of loss available to carry to subsequent years is reported on Line 9 of the Schedule B (2000 and subsequent forms) or Line 8 of the Schedule B (1999 and prior forms).

- The amount of NOL used in a particular year is the amount shown on Line 1 of the Schedule B minus the amount available to carry to subsequent years.

- Federal NOL carryforwards are shown as a negative amount on the "Other income" line of the federal Form 1040 (line 21). Form 1040 requires only that a taxpayer attach a schedule showing the computation of the NOL available to carry into the year. These computations can be checked using Schedule B of Form 1045.

Form 1045 Schedule B starts out with adjusted gross income (AGI), minus the itemized deductions, and modified to eliminate items not allowed in the computation of the NOL. In general, the following items are **not** allowed when figuring an NOL:

- Any deduction for personal exemptions
- Capital losses in excess of capital gains
- The IRC § 1202 exclusion of 50% of the gain from the sale or exchange of qualified small business stock
- Non-business deductions in excess of non-business income
- Net operating loss deduction
- The domestic production activities deduction

Schedule B can be used to figure the modified taxable income for carryback years and the carryover from each of those years. As for carrybacks, in any given tax year, the NOL can only be consumed to the extent of modified taxable income with the excess applied to the next succeeding year.

The computation of the federal NOL can be very complex. IRS Publication 536, Net Operating Losses (NOLs) for Individuals, Estates, and Trusts, provides complete information on NOLs. Find IRS Publication 536 at: www.irs.gov/pub/irs-pdf/p536.pdf

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3. DETERMINING PRORATED CAPITAL LOSSES FOR FEDERAL & ILLINOIS RETURNS

The federal limitation on capital losses is governed by IRC § 1211. In the case of a taxpayer other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus (if such losses exceed such gains) the lower of:

1) $3,000 ($1,500 in the case of a married individual filing a separate return), or
2) The excess of such losses over such gains.

Since Illinois follows this same federal limitation of ($3,000) on net capital losses, it is important to properly prorate such capital losses for both federal and Illinois returns, where warranted. The following presents an example of proration for federal determination first and then for the Illinois return.

a) Federal Proration

In determining the prorated losses for Illinois, the Schedule K-1-P amounts (Column A) must be used for the capital gains and losses to calculate the percentages used federally for prorating those losses. Schedule K-1-P Column A lines concerning capital gain or loss are: 16, 17, 18, 26 and 27. Below shows the partner's share taken from Column A for John and Jane Taxpayer (married filing jointly) for the three listed partnerships.

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John and Jane Taxpayer
SSN: XXX-XX-1234 Spouse SSN: XXX-XX-9876
2012 Capital Loss Proration - Federal

PARTNERSHIPS	12-####### ABC LLC	20-####### DEF LTD	27-####### GHI LLC	TOTALS
SHORT TERM GAINS	$33,091	$2,918		
SHORT TERM LOSSES			($193)	
NET SHORT TERM GAIN/LOSS				$35,816
LONG TERM GAINS		$1,290	$1,525	
TOTAL SHORT/LONG TERM GAIN				$38,631
LONG TERM LOSSES	($134,006)	($11,412)		
TOTAL SHORT/LONG TERM LOSS				($145,611)
LOSS % DETERMINATION	(134006) ÷ (145418) = 0.9215	(11412) ÷ (145418) = 0.0785	(193) USED 100%	(145611)-(193) = (145418)
FEDERAL LIMITATION IS ($3000) - TOTAL GAIN $38631 MUST BE OFFSET BY LOSSES - LOSS AMOUNT USED IS ($41631) AS [(41631) = (38631) + (3000)]				
PRORATED LOSS CALC FEDERAL	($41631) X 0.9215 = ($38364)	($41631) X 0.0785 = ($3267)	($193) USED 100%	

1) The taxpayers get to use 100% of the ($193) in short term loss for GHI LLC. Only the long-term losses for both ABC LLC and DEF LTD are partially used and must be prorated.

2) To calculate this proration, the loss percentage must be determined. The total short and long-term loss is ($145,611). However, of that total amount, ($193) is already accounted for – used 100%. That leaves ($145,418) to be accounted for [145,611 – 193 = 145,418]. The loss % for the other two partnerships is figured as follows:

a) ABC LLC: ($134,006) ÷ ($145,418) = 0.9215
b) DEF LTD: ($11,412) ÷ ($145,418) = 0.0785

3) In determining the total short/long term gain amount of $38,631, the short-term gains and losses are netted first yielding $35,816, which is then added with the long-term gains [$1,290 and $1,525]. This total gain amount, $38,631 must be offset by losses, and losses are used to generate the ($3,000) net federal capital loss deduction allowed. Therefore, the amount of available loss to be used will be ($41,631). [($41,631) - $38,631 = ($3,000)].

4) The ($41,631) is multiplied by each loss % as follows:

a) ABC LLC: ($41,631) X 0.9215 = ($38,364)
b) DEF LTD: ($41,631) X 0.0785 = ($3,267)

The loss amounts utilized federally should be: ($38,364) for ABC LLC, ($3,267) for DEF LTD and ($193) for GHI LLC.

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b) Illinois Proration

The Illinois portion of the losses actually used is then determined by multiplying each loss used by the percentage of that loss sourced to Illinois. The Illinois losses and percentages are:

Partnership	ABC	DEF	GHI
Short-Term Loss			
Federal Amount			$193
Illinois Amount			$193
Illinois Percentage			100%
Long-Term Loss			
Federal Amount	$134,006	$11,412	
Illinois Amount	$23,472	$4,312	
Illinois Percentage	23,472 ÷ 134,006 = 17.52%	4,312 ÷ 11,412 = 37.78%	

a) ABC LLC: ($38,365) X 0.1752 = ($6,722)
b) DEF LTD: ($3,267) X 0.3778 = ($1,234)

Total Illinois loss used was therefore $8,149 = $193 + $6,722 + $1,234

C. ILLINOIS NOL

Individuals were never allowed Illinois loss carry-backs or carryovers under IITA § 207 because there is no reference to § 203(a) for individuals. However, individuals, resident and nonresident, were always allowed a federal net operating loss if it was allowed in computing adjusted gross income because the Illinois taxable base starts out with federal AGI.

Under IITA § 203(a) and (h), an individual starts the computation of Illinois base income with his or her federal adjusted gross income for the year and makes only the modifications specified. Therefore, the federal net operating loss deduction that goes into the computation of Illinois base income is going to be exactly the amount that is used for federal income tax purposes in that year.

In applying NOLs for federal income tax purposes, the only things that matter are:

1) whether there is sufficient NOL to reduce taxable income to zero and

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2) if so, how much NOL remains available to carry to other years.

ILLINOIS DOUBLE DEDUCTION RULE

The IRC contains no definition of how much NOL is actually deducted in a year in which the NOL is great enough to reduce taxable income to zero, and the federal forms contain no place for computing that amount. It is often the case that taxpayers will report to the IRS an NOL deduction as reducing adjusted gross income to zero or even a negative number, and the IRS will make no correction.

- 86 IAC § 100.2410 provides that the amount of NOL deduction actually taken for a taxable year is the amount available for deduction in that year minus the amount available to carry to subsequent years, because IITA § 203(g) prohibits double deductions of the same carryover.

  Example: An individual, resident or nonresident has a federal NOL of $20,000. The taxpayer is a full-year Illinois resident in the carry back year and has reported an AGI of $10,000 and itemized deductions of $6,000; so only $4,000 of the NOL may be used federally in the carry year. For Illinois purposes in the carry year the taxpayer reported $10,000 on the Form IL-1040, Line 1. The taxpayer may reduce his Illinois Line 1 by the same $4,000 amount that was allowed federally. To allow more than the $4,000 could result in a future double deduction not allowed under IITA § 203(g). Ref: 86 IAC § 100.2410(a)(1).

- Under *Madison Park Bank v. Zagel,* 97 Ill.App.3d 743 (1981), aff'd 91 Ill.2d 231 (1982), the deduction of the same NOL in more than one year is not allowed for Illinois income tax purposes.

D. ILLINOIS NOL CARRYBACKS & CARRYOVERS

Again, since IITA § 207 contains no provision for individual net operating losses, we can only allow a federal NOL in the year that the NOL is used in the computation of federal AGI.

For Illinois purposes the NOL is always shown as a change to federal AGI; it is never shown as a subtraction modification.

- For Illinois residents any federal carryback or carryforward is allowed as an adjustment to AGI on Line 1 of the Form IL-1040-X.

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- At the top of the Form IL-1040-X in Step 1 there is a box that the taxpayer checks to indicate there is a federal NOL along with a place for a date on when the federal NOL was accepted.

- If the amended return results in a refund, the taxpayer has two years and 120 days after the federal finalization date to file the Form IL-1040-X.

- Taxpayers are required to attach to their Form IL-1040-X:

  - A copy of the federal Form1040X (or Form 1045)

  - A copy of the notification received from the IRS that they accepted the changes shown on the federal Form 1040X. This notification could be a copy of either a refund check, "Statement of Account" agreement, or judgment order.

  - If some of the NOL carried to the taxable year remains available to carry to the next taxable year, Form 1045 Schedule B (whether or not Form 1045 was filed). Ref: Form IL-1040-X Instructions.

Note: If a taxpayer is a full-year resident during the year, they are allowed to deduct the full amount of an NOL that was deducted federally in the carry year, even if the NOL came from a year in which the taxpayer was a nonresident.

NOL CARRYBACK BREAKDOWN ANALYSIS

When addressing the carryback of losses, it may be necessary to complete a breakdown analysis, especially if dealing with losses reported from multiple entities. The following breakdown for John and Jane Taxpayer will be used in this explanation, which involves the 2010 losses that were carried back to 2008.

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John and Jane Taxpayer
SSN: XXX-XX-7707 SPOUSE SSN: XXX-XX-8686 8/28/2015
2008 IL-1040-X NOL CARRYBACK

NOL BREAKDOWN: $4,794,266 This amount will come from either the 2010 federal 1040X or federal Form 1045 - Application for Tentative Refund if filed

	(a) LOSSES REPORTED	(b) TOTAL LOSS	(c)* *(a)/(b) LOSS RATIO	(d) TOTAL AMOUNT OF LOSS FROM 2010	(e)* *(a)X(h) (h)=75.87% ALLOCATED NOL	(f) IL C/B YEAR 2008 BUSINESS APPORTIONMENT FACTOR	(g)* *(e)X(f) ILLINOIS NOL
20-####### L PROPERTIES, LLC (SCHEDULE C)*	$ 4,749	$ 6,319,238	0.08%	$4,794,266	$ 3,603	0.000000	$ -
73-####### K MACHINERY (SCHEDULE E)	$ 5,956,672	$ 6,319,238	94.26%	$4,794,266	$ 4,519,195	0.032960	$ 148,953
73-####### TC, INC. (SCHEDULE E)	$ 994	$ 6,319,238	0.02%	$4,794,266	$ 754	0.000000	$ -
27-####### FOX FUN COMPANY (SCHEDULE E)	$ 2,228	$ 6,319,238	0.04%	$4,794,266	$ 1,690	0.000000	$ -
73-####### K MACHINERY (SCHEDULE 4797)	$ 354,582	$ 6,319,238	5.61%	$4,794,266	$ 269,014	0.032960	$ 8,867
UNKNOWN FEIN R HOLD COMPANY, INC. (SCHEDULE 4797)	$ 13	$ 6,319,238	0.00%	$4,794,266	$ 10	0.000000	$ -
TOTAL	$ 6,319,238		100.00%		$ 4,794,266		**$ 157,819**

NOL Percentage = $4,794,266/$6,319,238 = 75.87% **(h)**

According to IAC Section 100.2410(b), the Net Operating Loss Deduction can only reduce Illinois income based on the Illinois portion of the loss for the entity and its apportionment to Illinois in the carry back year.

*L PROPERTIES, LLC is a sole proprietorship which did not apportion any Schedule C income to Illinois in 2008.

1) In determining "Losses Reported" in Column (a), these amounts may be found on different forms (i.e. Schedule C, Schedule E, Schedule 4797, etc.) dependent upon the reporting entity. These amounts should be added together for a "Total Loss" amount, in this case $6,319,238. This amount is then entered Column (b) – Total Loss.

2) The "Loss Ratio" in Column (c) is determined by dividing the "Losses Reported" in Column (a) by the "Total Loss" in Column (b). This represents the percentage of the total losses for each entity. Example from above: $4,749/$6,319,238 = 0.08%.

3) The "Total amount of Loss from 2010" is reported in Column (d). The "Allocated NOL" amounts in Column (e) are determined by multiplying the "Losses Reported" in Column (a) by the NOL percentage which is (h) – 75.87% in this example. (h) is calculated by dividing the Allocated NOL [$4,794,266] by the Total NOL reported [$6,319,238].

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4) The "Illinois Carryback Year (2008) Business Apportionment Factor" in Column (f) will be needed for determining the amount of "Illinois NOL". This apportionment factor in (f) is multiplied by the "Allocated NOL" in Column (e) to determine the amount of Illinois NOL in Column (g). Example from above: 0.032960 X $4,519,195 = $148,953.

5) All of the Illinois NOL amounts in (g) will then be added together for the total Illinois NOL that is available. In this case, that amount is $157,819.

E. NOLS – APPORTIONMENT

1. RESIDENTS

Under IITA § 301(a), a resident allocates to Illinois "[a]ll items of income or deduction which were taken into account in the computation of base income."

- The entire NOL deduction allowed to a resident is allocated to Illinois, even if the NOL is from sources outside Illinois and was incurred while the individual was a nonresident.

2. NONRESIDENTS

- Nonresidents allocate and apportion all items of income and deduction according to the facts and circumstances of the year in which the items are taken into account.

- A nonresident must use his or her apportionment factor for the year of the deduction to apportion that deduction, even if he or she was a resident in the year the loss was incurred and even if the apportionment fraction for the year of the deduction is different from the fraction for the year the loss was incurred.

- Nonresidents report a federal NOL on the line for "Other Income" on Schedule NR. This line on the NR is intended to coincide with the "Other Income" line on the federal Form 1040.

    - On an NOL carryover the taxpayer attaches Schedule NR, showing the NOL carryover, to his Form IL-1040.

    - On an NOL carryback, the taxpayer attaches a revised Schedule NR to his Form IL-1040-X.

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Nonresident Sole Proprietorship, Partnership (or an S Corporation)

1) A loss from a sole proprietorship, partnership or an S corporation is allocated to Illinois to the same extent that business income from that entity is apportioned to Illinois for the carry year. This is the exact opposite of how Illinois net losses are applied under IITA § 207, which expressly provides that those losses are computed after apportionment in the loss year and are applied to reduce income after apportionment in the carryover year.

   Example: A nonresident individual conducts a business as a sole proprietorship. During 2008, the individual apportions 20% of his business income from the proprietorship to Illinois pursuant to IITA § 304(a). In 2010, the business is conducted entirely outside Illinois and has no Illinois apportionment factor. If the individual incurs a net operating loss in 2010 from the sole proprietorship and carries the loss back to 2008, 20% of the loss will be apportioned to Illinois.

2) A nonresident may have losses from one or more business entities doing business in Illinois, which is partially offset by other income. This results in a federal NOL that is less than the business loss incurred by an Illinois business entity. In this case the net federal NOL is allocated among the entities in a prorated manner; then carried back or forward and the deduction is allocated to Illinois based on the extent of Illinois activity in the carry year. Ref: 86 IAC § 100.2410(b)(2).

   Example: In 2002, Taxpayer, a nonresident individual, has $20,000 in federal net losses from Partnership A and $180,000 in net losses from Partnership B. Taxpayer has $100,000 in income from other sources. Taxpayer's adjusted gross income for 2002 is a net operating loss of $100,000. $10,000 of the loss [$100,000 loss, x ($20,000 in Partnership A loss divided by $200,000 in total losses)] is attributed to Partnership A and $90,000 of the loss [$100,000 loss, x ($180,000 in Partnership B loss divided by $200,000 in total losses)] is attributed to Partnership B. Taxpayer carries the entire 2002 loss of $100,000 back to 2000, when Partnership A's Illinois apportionment factor is 30% and Partnership B's apportionment factor is zero. In determining Taxpayer's Illinois net income for 2000, if the entire $100,000 loss deduction is used in that year, the portion of the loss apportioned to Illinois is $3,000, which is 30% of the $10,000 Partnership A loss plus 0% of the Partnership B loss. If only $30,000 of the loss is used in 2000, the Partnership A loss used in the year is $3,000 [$30,000 in losses used, x ($10,000 Partnership A loss divided by $100,000 total loss carried into the year)], and the amount

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apportioned to Illinois is $900 (30% of $3,000). Ref: 86 IAC § 100.2410(b)(2).

3) The allocation of losses can result in a nonresident's income being less than zero, but in no case can such an amount be carried forward or back under IITA § 207.

Example: For federal income tax purposes, a nonresident individual has positive adjusted gross income for a taxable year. For that year, the individual has $200,000 in base income from sources outside Illinois and a $20,000 loss, all of which is allocable to Illinois. The individual's Illinois net income for the year is therefore less than zero. Because IITA Section 207 does not apply to individuals, and there is no other provision for carryovers of losses or deductions, the individual may not carry that negative amount over to any other taxable year. Ref: 86 IAC § 100.2410(c)(3).

F. ITEMIZED DEDUCTIONS

Schedule A (Form 1040), Itemized Deductions, is an important element when determining the amount of Net Operating Loss (NOL) on Schedule A- NOL (Form 1045), and when figuring the modified taxable income for each carryback year (and any amount to be carried over from those years) on Schedule B- NOL Carryover (Form 1045). For an audit that involves a federal NOL, a potential area of concern should be the proper application of the itemized deductions by the taxpayer (individual).

1. SCHEDULE A- NOL (FORM 1045)

Non-business deductions (line 6) on Schedule A (Form 1045) includes deductions not connected to the taxpayer's trade/business or employment. These deductions include:

- Alimony paid,
- Deductions for contributions to an IRA or a self-employed retirement plan,
- Health savings account deduction,
- Archer MSA deduction,
- The additional exemption amount for providing housing to a Midwestern displaced individual from Form 8914, line 2,
- Most itemized deductions (except for casualty and theft losses, state income tax on business profits, and any employee business expenses), and
- The standard deduction (except the amount of any net disaster loss from Form 4684, line 18a).

Not to be included is the deduction for personal exemptions for the taxpayer, spouse, or any dependents.

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2. SCHEDULE B- NOL CARRYOVER (FORM 1045)

Adjustments to Itemized Deductions (line 7) on Schedule B (Form 1045) will be used in calculating the modified taxable income (line 9). When modified taxable income is subtracted from the NOL deduction (line 1), the amount of NOL carryover (line 10) is determined.

For a complete examination of Schedule, A and B (Form 1045), see either the instructions for Form 1045, Application for Tentative Refund or Publication 536, Net Operating Losses (NOLs) for Individuals, Estates, and Trusts at: http://www.irs.gov/

G. PASS-THROUGH INCOME ENTITIES

Income (and/or gains, losses, deductions, and credits) passes through from Partnerships, S Corporations, and Trusts or Estates to the individual partners, shareholders, or beneficiaries.

When auditing a return with a federal NOL, it is important to check Schedule A- NOL (Form 1045) line 7, Non-business Income. Included in this figure should be an individual's share of any non-business income passed from partnerships and S Corporations.

For Illinois income tax purposes, partners/shareholders are deemed to have received their entire distributive shares of partnership/S corporation income (loss) on the last day of the partnership's/S corporation's taxable year. A partner/shareholder will be determined to be a resident or a nonresident as of the end of the partner's/shareholder's tax year, in relation to the tax year end of the partnership/S corporation.

If the partnership's/S corporation's tax year end is within the portion of the tax year that the partner/shareholder was a resident, then all income received is taxed based on IITA 301(a). Column B must be completed to provide residents with information needed for the Schedule CR.

If the partnership's/S corporation's tax year end is within the portion of the tax year that the partner/shareholder was not a resident, then all income passed through to the partner/shareholder is taxed only to the extent it is allocated or apportioned to Illinois.

1. PARTNERSHIPS

The income, gains, losses, deductions, and credits of a partnership are passed through to the partners based on each partner's distributive share of these items, which is based on the partnership agreement. This distributive share must be reported on the partner's individual income tax returns (federal and state) regardless of whether or not there was an actual distribution by the partnership. Note that the distributive share of partnership

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losses is limited to the adjusted basis of the partnership interest at the end of the partnership year in which the loss occurred.

The partner's individual Income Tax return (Federal 1040) should be reflective of the partnership in that:

1) If the partnership had a capital gain, the partner would report the distributive share on Schedule D (Form 1040), Capital Gains and Losses
2) If the partnership had generated operating income, the partner would report the~~ir~~ distributive share of this income on Schedule E (Form 1040), Supplemental Income and Loss.
3) A partner would report the distributive share of non-operating income of a partnership (such as interest and dividends) on his Form 1040 as if he had received that income directly rather than through the partnership.

For state return purposes (Form IL-1040), a partner should receive a completed Schedule K-1-P, Partner's or Shareholder's Share of Income, Deductions, Credits, and Recapture, from the partnership. This Schedule K-1-P will show the partner's specific share of each item to be reported on the partner's Individual Income Tax return. A copy of this K-1-P must be attached to the Form IL-1040 when filed.

2. S CORPORATIONS

An S Corporation functions primarily as a conduit for transferring the income (and/or losses, deductions, and credits) directly to the shareholders. The shareholders will then report these items on their Individual Income Tax returns based on that shareholder's percentage of stock ownership (shareholder's pro rata share) for that taxable year.

Note that S Corporation distributions are generally a nontaxable return of the shareholder's basis in the corporation stock. However, in certain cases, part of the distribution may be taxable as a dividend, or as a long-term or short-term capital gain, or both.

For state return purposes (Form IL-1040), a shareholder (individual) should receive a completed Schedule K-1-P, Partner's or Shareholder's Share of Income, Deductions, Credits, and Recapture, from the S Corporation. This Schedule K-1-P will show the shareholder's specific share of each item to be reported on their Individual Income Tax return. A copy of this K-1-P must be attached to their Form IL-1040 when filed.

SCHEDULE D (FORM 1040), CAPITAL GAINS AND LOSSES

When S Corporation distributions to shareholders are recognized as either long-term or short-term capital gains, or both, Schedule D figures will be reported on Line 13 of the Federal 1040. Again, as this amount is included in AGI, an audit

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review is important in determining proper shareholder pass-through for Illinois tax purposes.

3. TRUSTS OR ESTATES

Income from a trust or estate is often passed on to the beneficiaries who must report this income on their Individual Income Tax returns.

For Form IL-1040, a beneficiary should receive a completed Schedule K-1-T, Beneficiary's Share of Income and Deductions, from the trust or estate. This Schedule K-1-T will show the beneficiary's specific share of each item to be reported on their Individual Income Tax return. A copy of this K-1-T must be attached to their Form IL-1040 when filed.

a) SCHEDULE E (FORM 1040), SUPPLEMENTAL INCOME AND LOSS

The figures compiled on Schedule E will be reported on Line 17 of the Federal 1040 which is included in the AGI total. Since the starting point for Illinois Income Tax determination is AGI, a review of the Schedule E information is important when recognizing any income or loss passed-through from a partnership, S Corporation, Trust, or Estate.

b) SCHEDULE K-1-P OR K-1-T

These schedules reflect the specific share of the partner's, shareholders or beneficiary's income (and/or gains, losses, deductions, and credits) passed through from the partnership, S Corporation, or Trust or Estate. A copy of the K-1-P or K-1-T must be attached to the Form IL-1040 when filed.

4. DISREGARDED ENTITIES AND GRANTOR TRUSTS

a) DISREGARDED ENTITIES

Under Treasury Regulations § 301.7701-2(a), a business entity with a single owner is either classified as a corporation or is disregarded as an entity separate from its owner. 26 CFR 301.7701-2(a). If a business entity is disregarded as an entity separate from its owner, then its activities are treated in the same manner as a sole proprietorship. In such a case, the items of income, gain, loss, and deduction of the disregarded entity are considered the items of the owner, which are taken into account in computing the federal taxable income (Form 1040) of the owner. Unless a single member LLC elects to be treated as a corporation, it is considered a "disregarded entity" by the IRS.

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Under IITA § 102 and § 203, the federal treatment of a disregarded entity and its owner applies for Illinois income tax purposes. An entity that is disregarded for federal income tax purposes is disregarded as an entity for Illinois purposes, and the items of base income of the disregarded entity are considered the items of the owner and are taken into account in computing the Illinois base income of the owner. The same treatment extends to the determination of the apportionment factor of the owner of a disregarded entity. The activities of the disregarded entity are considered the activities of the owner for purposes of applying the apportionment provisions of Article 3 of the IITA.

In the case of an individual, as owner of the disregarded entity, sole proprietorship (sole prop) rules would apply. Items of income, gain, loss, and deduction of the disregarded entity should be reported by the owner (individual) on federal Schedule C, Profit or Loss from Business, when filing Form 1040.

> Example: A single individual owned a real estate company (LLC), which is classified as a disregarded entity. When computing his federal taxable income for federal Form 1040, Schedule C would need to be completed to report the items from the LLC, which are considered items of the owner (sole prop). Since the owner is an Illinois resident, the federal application as to the disregarded entity and its owner applies for Illinois income tax purposes.

b) GRANTOR TRUSTS

A Grantor trust is any trust which, under IRC §§ 671-677 and §679, is taxed as if owned in whole or in part by the trust's creator (grantor). The grantor retains certain powers over the trust which includes: power to revoke (amend or terminate) the trust and control over the property inside the trust. With this type of trust, all items of income and deduction are declared through the grantor's Form 1040.

c) SCHEDULE K-1-P AND SCHEDULE K-1-T – DISREGARDED ENTITY OR GRANTOR TRUST

If the partner, shareholder or beneficiary listed in Step 2 on the K-1-P/K-1-T is a Disregarded Entity or Grantor Trust for federal and Illinois income tax purposes, the applicable box on Schedule K-1-P (Line 9b) or Schedule K-1-T (Line 8b) would need to be checked by the disregarded entity, and the name and identification number completed with the taxpayer who is the "responsible reporting party". A copy of this K-1-P/K-1-T should be provided to the named individual (or entity) that would then be responsible for reporting the amounts presented (items of income, gain, loss, etc.). For an individual, these would be reported through his/her individual income tax return.

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Note: The above line references for both schedules (K-1-P/K-1-T) are for 2013. The same schedules for previous years may present with different line numbers.

Example: For tax year 2013, Company A issues a K-1-P to Company B. Since Company B is a Disregarded Entity, the K-1-P is passed on to an individual (owner of Company B). To do this, Company B checks the appropriate box (Disregarded Entity), writes in the name and identification number (SSN) of the individual (in Line 9b) and sends it on to that individual, who will then report (on their individual income tax return) the income/loss or claim any payments made on behalf of Company B. In this situation, the taxpayer listed on Step 2, Line 5 of the K-1-P (Company B) would not claim the income/loss/payments since it is a disregarded entity.

For an in-depth examination of pass-through entities, see Audit Manual Chapter 28 - S Corporations, Partnerships, IL-1041 Trusts and Estates, Composite and PTE Returns.

VIII. ADDITION MODIFICATIONS

IITA § 203(a)(2) allows for the modification of AGI by additions and subtractions.

A. FEDERALLY TAX-EXEMPT INCOME
IITA § 203(a)(2)(A)

Any federally tax-exempt interest and dividend income must be added back on line 2 of the Form IL-1040.

The amount of federally tax-exempt interest and dividend income can be vouched from the U.S. 1040 or 1040A, Line 8b, or U.S. 1040EZ. This may be from municipal bonds, a mutual fund, or a regulated investment company. Each payer should send the taxpayer a Form 1099-INT, entering the tax-exempt income in box 8.

Note that any distributive share of federally tax-exempt interest and dividend income received from a partnership, an S corporation, an estate, or a trust is added back on Schedule M, Other Additions and Subtractions for Individuals, Line 2. This amount should be found on the taxpayer's Schedule K-1-P or Schedule K-1-T.

B. ILLINOIS INCOME TAX DEDUCTED IN COMPUTING AGI
IITA § 203(a)(2)(B)

The total amount of any Illinois Income Tax that was deducted from gross income on the federal 1040 must be added back. Because individual Illinois income tax is a federal

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itemized deduction, this subtraction would be for deductions for replacement taxes of a partnership or S corporation and passed through to the individual.

C. OTHER ADDITIONS TO INCOME

Certain income additions require the completion of Schedule M, Other Additions and Subtractions for Individuals, which correspond to IITA § 203(a)(2)(C) through (D-24). The total of the additions on Schedule M is then carried to Line 3 of the Form IL-1040.

Note: The list of additions on Schedule M can change per tax year, therefore, check each individual tax year for changes.

Per the form IL-1040 return instructions for tax year 2018, a taxpayer would complete Schedule M if they have any of the following items:

- your child's federally tax-exempt interest and dividend income as reported on federal Form 8814
- a distributive share of additions you received from a partnership, S corporation, trust, or estate
- Lloyd's plan of operation loss, if reported on your behalf on Form IL-1065, and included in your adjusted gross income
- earnings distributed from IRC Section 529 college savings and tuition programs and ABLE plans if these earnings are not included in your adjusted gross income, Line 1
- an addition amount calculated on Form IL-4562, Special Depreciation
- business expense recapture (nonresidents only)
- recapture of deductions for contributions to Illinois college savings plans and ABLE plans transferred to an out-of-state plan
- credit received on Schedule 1299-C for student-assistance contributions made as an employer on behalf of your employees
- deductions claimed in prior years for college savings plan and ABLE plan contributions if you made a nonqualified withdrawal this tax year
- A Domestic Production Activities Deduction (DPAD) amount from fiscal-year pass-through entities included on federal Form 1040, Schedule 1, line 36.
- any other amounts that you are required to add to your federal adjusted gross income

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Schedule M must be completed, with any required supporting documents (U.S. Form 8814, Schedule K-1-P or K-1-T, Form IL-1023-C, or Form IL-4562), and must be attached to the Form IL-1040. For more information, click on the Schedule M instructions under the specific current or prior year at http://tax.illinois.gov/taxforms/individual.htm.

Note: PA 100-022 provides for the following addition: for tax years ending on or after December 31, 2017, the Domestic Production Activities Deduction allowed under Section 199 of the Internal Revenue Code must be added back to the adjusted gross income (for individuals).

IX. SUBTRACTION MODIFICATIONS

The Base Income section of the Form IL-1040 allows for subtraction modifications to the total income per IITA § 203(a)(2)(E) through (HH).

A. FEDERALLY TAXED SOCIAL SECURITY BENEFITS AND CERTAIN RETIREMENT PLANS

Most retirement income may be subtracted if it is included in the Form IL-1040 Line 1 amount. This includes income from:

- **qualified employee benefit plans** (including railroad retirement and 401(K) plans) and **Individual Retirement Accounts** or **self-employed retirement plans** reported on federal Form 1040, Line 4b.
- **Social Security and railroad retirement benefits** reported on federal Form 1040, Line 5b.
- **government retirement and government disability plans and group term life insurance premiums paid by a qualified retirement plan** reported as wages on your federal Form 1040, Line 1.
- **state or local government deferred compensation plans** reported on federal Form 1040, Line 1 or 4b.
- **certain capital gains on employer securities** reported on federal Form 1040, Schedule 1, Line 13.
- **certain retirement payments made directly to retired partners** reported on federal Form 1040, Schedule 1, Line 17.

Page 1 of the federal Form 1040 (or 1040A) and any W-2 and 1099 forms are required attachments for these subtractions. The simplest retirement income to verify is IRAs, qualified employee benefit plans, and Social Security reported on Lines 15b, 16b, and

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20b of the federal Form 1040 (11b, 12b, and 14b of the U.S. 1040A). Others may require more scrutiny.

- Retired partners sometimes claim their Form IL-1040 retirement subtraction and only provide a copy of their federal return, which is not sufficient to identify and verify this income. Retired partners must provide, in addition to a copy of page 1 of their federal Form 1040, their Schedule K-1-P, Schedule K-1-T, or any other notification identifying their share of the income received from the partnership, S-Corp, trust, or estate, which includes the payer's name and federal employer identification number (FEIN).

- Reviewing the taxpayer's Schedule E would also be a good idea. The main purpose behind reviewing this subtraction is to make sure that it was included in the taxpayer's subtraction, because taxpayers will often try to subtract all retirement income, whether it was included in their AGI or not. Taxpayers cannot deduct federally tax-exempt retirement that is reported on Lines 15a, 16a, and 20a, since this is already tax-exempt at the state level by not being included in their AGI.

For more information, refer to Publication 120, Retirement Income, at: http://tax.illinois.gov/Publications/Pubs/Pub-120.pdf

The retirement subtraction is found on Line 5 of Form IL-1040.

PAYMENT OF BENEFITS IN EXCESS OF IRC SECTION 415 LIMITATIONS

IITA § 203(a)(2)(F) permits taxpayers to deduct distributions from retirement plans- including all retirement or disability plans of government agencies- that are included in federal adjusted gross income (AGI). It is the general practice of the Illinois Department of Revenue to disallow the deduction for any distribution that is not reported on a Form 1099-R, "Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRA's, Insurance Contracts, etc."

However, distributions by the Illinois Teachers Retirement System in excess of IRC Section 415 limitations (Excess Benefit Fund payments) are distributions from a retirement plan of a government agency, regardless of how they are reported. Due to federal law requirements, such benefit payments (distributions) are reported on a Form W-2, "Wage and Tax Statement", rather than on a Form 1099-R. Although reported on a W-2, such distributions are deductible for purposes of the IITA.

These payments from the Excess Benefit Fund should be an allowable deduction from the taxpayer's AGI reported on the Form IL-1040 Line 1. This issue affects

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taxable years 2007 and subsequent years. Taxpayers must provide copies of their federal return and Form W-2 identifying this income and that it is included in their AGI.

B. ILLINOIS INCOME TAX OVERPAYMENT

The total amount of any Illinois Income Tax overpayment reported as income on the federal Form 1040, Line 10 may be subtracted per IITA § 203(a)(2)(H).

Note that this overpayment amount does not include any refund from other states. These refunds are subtracted on the Schedule M if the tax being refunded was an itemized deduction on the federal return. Also, this subtraction may not be taken if a federal Form 1040A or 1040EZ return was filed.

This subtraction is recorded on Line 6 of Form IL-1040.

C. MILITARY PAY EARNED

Note: For the taxable years **2008 and forward**, Military pay earned was **moved** from the Base Income section of the Form IL-1040 to the Subtraction section of the Schedule M. This subtraction is recorded on IL Schedule M and subsequently on Line 7 of Form IL-1040.

Per IITA § 203(a)(2)(E), for the taxable years ending on or after December 31, 2007, the amount of military pay that was received from the U.S. Armed Forces or the National Guard of any state may be subtracted. For the taxable years ending on or after December 31, 2001, the military pay that could be subtracted was received from the U.S. Armed Forces or the Illinois National Guard.

The following are not allowed to be included in the subtraction:

1) Combat pay that was not included in the AGI on line 1
2) Pay that was received
    - Under the Voluntary Separation Incentive
    - From the military as a civilian
    - Under the Ready Reserve Mobilization Income Insurance Program
    - For duty as an officer in the Public Health Service

The W-2 form showing Military pay must be attached to the Form IL-1040 for the subtraction to be allowed. A common error of taxpayers is to subtract military pay received as a civilian. Auditors should review the W-2 to make sure that it indicates military and not civilian pay. Generally, military W-2s have these characteristics:

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- An employer FEIN ending in “0000”.
- A “Q” in box 12
- An Employer address in
  Indianapolis, Indiana — Army
  Denver, Colorado — Air Force
  Cleveland, Ohio — Marines and Navy

For more information on the Military Pay subtraction, see Publication 102. Information on the Military Spouse Residency Relief Act can be seen in Section V.A.3 of this same chapter.

D. U.S. TREASURY BONDS, BILLS, NOTES, SAVINGS BONDS, AND U.S. AGENCY INTEREST

Note: For the taxable years **2008 and forward,** the subtraction for U.S. Treasury bonds, bills, notes, savings bonds, and U.S. agency interest was **moved** from the Base Income section of the Form IL-1040 to the Subtraction section of the Schedule M.

Income included in Line 1 of the Form IL-1040 that was received from U.S. Treasury bonds, bills, notes, savings bonds, and U.S. agency interest income may be subtracted per 86 IAC § 100.2470(a).

Proper verification attachments for the Form IL-1040 should include (if applicable):

- a copy of the U.S. 1040, Schedule B or U.S. 1040A, Schedule 1
- a copy of any mutual fund statement
- any worksheets that identify U.S. obligation interest.

Note: As of tax year 2009, the federal Schedule 1 is obsolete. All taxpayers will use the Schedule B for both the U.S.1040 and 1040A.

Certain federal interest income is not exempt from Illinois income taxation per 86 IAC § 100.2470(h). This would include:

- income from securities known as GNMA “Pass-Through Securities” or GNMA “Mortgage-Backed Securities”

- income from debentures, notes, and bonds issued by the Federal National Mortgage Association (FNMA). Also, not exempt is the income received from the holding of Federal Home Loan Mortgage Corporation (Freddie Mac) obligations.

COMMON TAXPAYER MISTAKES

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1) Subtracting interest from <u>any</u> municipal bond, especially if it is some type of Illinois bond.

   - Only interest from statutorily listed bonds can be subtracted, as seen on Schedule M.
   - Other state municipal bonds cannot be subtracted, nor can most Illinois municipal bonds, unless it is shown on the Schedule M. Since there is no line for unauthorized bonds, the taxpayer often just includes them in the total with a description (e.g. "Other" or "Exempt Bond Interest") and maybe attaches a schedule to identify them.

   <u>Example</u>: Taxpayer claims $5,000 in interest from Illinois municipal bonds on the 2010 Schedule M, but does not identify as shown on Lines 32a-m or 33a-f. Instead, the amount is included on the total line with a description "Bond Interest Subtraction-Schedule 4." On Schedule 4, the following bonds are identified:

O'Hare Revenue Authority	$2,000
CTA Finance Authority	$1,500
Wisconsin Development Finance Authority	$1,000
Illinois Development Finance Authority	$500

   The only statutorily allowable municipal bond to claim (assuming it was added back on Form IL-1040 Line 2) an interest subtraction that is found in Publication 101 and 86 IAC § 100.2470 is $500 from Illinois Development Finance Authority, which should be identified on Schedule M Line 32c, h, or j. The others should be disallowed.

2) Subtracting interest from statutorily allowable bonds that are owned through a mutual fund. While this is allowable for U.S. obligation interest and certain other income exempt from Illinois Income Tax by federal statutes, it is not allowable for income from other statutorily allowable municipal bonds. 86 IAC § 100.2470(f).

   - If the distribution is from a mutual fund, this subtraction deduction can only be the income attributable to U.S. government obligations and other income exempt by federal statutes. These are listed in 86 IAC § 100.2470(b) and (c).

     - If the fund contains only tax-exempt obligations, then the entire distribution may be subtracted.

     - If the mutual fund contains both exempt and non-exempt obligations, only the percentage amount of exempt obligations

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can be used. This percentage may be provided by the fund or required to be calculated by the taxpayer. The calculation is a fraction comprised of the numerator (fund amount of exempt obligations) and denominator (fund's total investment amount). See 86 IAC § 100.2470(d).

- It is extremely important to verify that exempt income that the taxpayer is trying to subtract was either included in AGI or was added back on Line 2 of the Form IL-1040. Method for computing the subtraction of exempt income is stated in 86 IAC § 100.2470(i).

Example: Taxpayer claims $5,000 on 2010 Schedule M Line 32f, "Illinois Sport Facilities Authority bonds," and attaches a mutual fund statement showing amount invested with the fund, shares owned, the fund's percentage ownership of different bonds, etc. This subtraction should be disallowed because indirect ownership of bonds through a mutual fund does not qualify for the subtraction. The bonds must be directly owned. Do not confuse that with U.S. obligations and other income exempt from Illinois Income Tax by federal statutes that can be owned through a mutual fund.

E. OTHER SUBTRACTIONS TO INCOME

Other items of income are allowable subtractions on the Schedule M. The total of these subtractions from Schedule M is then carried to Line 7 of the Form IL-1040.

Note: Subtraction modifications on Schedule M can change per tax year; therefore, check each individual tax year for changes.

To claim any of the "other" subtractions, the Schedule M must be completed and attached to the Form IL-1040. Supporting documents (Schedule K-1-P or K-1-T, Form IL-4562, U.S. 1040 Schedule B, U.S. 1040A Schedule 1, Schedule F, or Schedule 1299-C) may also be required attachments per the Schedule M instructions. For details, click on the Schedule M instructions under the specific current or prior year at: http://tax.illinois.gov/taxforms/individual.htm

Taxable income as modified from additions and subtractions cannot be less than zero. This amount is the Illinois base income, which is reported on Line 9 of Form IL-1040.

X. EXEMPTIONS

ILLINOIS EXEMPTION ALLOWANCE

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The number of exemptions claimed on Form IL-1040 should match the number reported on the federal return (box 6d). The exemption amount has changed throughout the years, which is provided for in IITA § 204(b).

IITA § 204(b) Standard Exemption Basic Amount

For taxable years ending on or after	Basic Exemption Amount – per person
December 31, 1998 and prior to December 31, 1999	$1,300
December 31, 1999 and prior to December 31, 2000	$1,650
December 31, 2000 and prior to December 31, 2012	$2,000
December 31, 2012 and prior to December 31, 2013	$2,050
December 31, 2013 and prior to January 1, 2024	$2,050 plus cost-of-living adjustment [§204(d-5)] – See Note 1 below
For taxable years beginning on or after	
January 1, 2017	See Notes 2 and 3 below

Note 1: Based on the provisions under § 204(d-5), for the 2013 tax year, the exemption amount was $2,100. For the 2014 tax year, the amount was $2,125. For the 2015 tax year, the amount was $2,150. For the 2016 and 2017 tax years, the amount was $2,175. For the 2018 tax year, the amount will be $2,225.

Note 2: Changes to Standard Exemption through PA 100-0865:
The standard exemption calculation including the cost-of-living adjustment has been extended to taxable years ending on or before December 31, 2023.

Note 3: Changes to Standard Exemption through PA 100-022:
For tax years beginning on or after January 1, 2017, the personal exemption allowance may not be claimed if the taxpayer's adjusted gross income (AGI) for the taxable year exceeds $500,000 for returns with a federal filing status of married filing jointly, or $250,000 for all other returns. This would also apply to the other exemptions allowed for under IITA Section 204, which includes being age 65 or older, or being legally blind. None of the exemptions under Section 204 can be claimed if the taxpayer(s) are over the AGI limitations for tax years beginning on or after January 1, 2017.

1. AGE 65 OR OLDER

IITA § 204(d)(1)(A) and (B) provide for an additional exemption of $1,000 for a taxpayer or spouse 65 years of age or older.

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2. LEGALLY BLIND

IITA § 204(d)(2)(A) and (B) provide for an additional exemption of $1,000 for blindness of the taxpayer or spouse.

On Form IL-1040, these exemptions are found on Line 10.

XI. NET INCOME

Net income is defined in IITA § 202 and 86 IAC § 100.2050(a) provides additional language.

A. ILLINOIS RESIDENTS

Net income is determined when the exemption allowance is subtracted from the Illinois base income. For Illinois residents, per IITA § 301(a), all Illinois net income earned by the taxpayer, regardless the source and whether earned within or without Illinois, will be allocated to and taxable by Illinois. The net income amount may not be less than zero.

B. NONRESIDENTS AND PART-YEAR RESIDENTS

On the Form IL-1040, the applicable box for nonresident or part-year resident must be checked, and Schedule NR (Nonresident and Part-Year Resident Computation of Illinois Tax) must be completed and attached. This information is recorded on Line 12 of Form IL-1040.

Schedule NR will be used to determine the income that is taxed by Illinois for that tax year and to calculate Illinois Income Tax (before any recapture of investment credits for tax year 2008 and after). Illinois base income determined on the Schedule NR will be written in the Net Income section of the Form IL-1040 for nonresidents and part-year residents only. This amount may not be less than zero.

SCHEDULE NR COMPLETION

Schedule NR, Nonresident and Part-year Resident Computation of Illinois Tax, must be completed and submitted with the Form IL-1040. Schedule NR is used to determine the income that is taxed by Illinois during the year and to figure the Illinois income tax.

a) Schedule NR Step 3

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To determine the Illinois portion of the reported federal adjusted gross income (AGI), Step 3 of Schedule NR must be completed by the part-year resident or nonresident.

- Column A is used to report the amounts shown on the federal return.
- Column B is used to report the portion of Column A that is taxed by Illinois (the Illinois portion).

Amounts present on certain lines within Schedule NR Step 3 may need to be examined and verified by the auditor. Note: Line references that follow are for taxable years 2008 and forward. For years prior to 2008, the Schedule NR line numbers may be different.

(1) Line 5, Column B – Illinois portion of wages:

Part-year residents or nonresidents may try to allocate a different amount of wages to Illinois on the Schedule NR than are shown on the Form W-2 and will claim the full amount of Illinois withholding. This is often the case because the taxpayer is claiming that the employer continued to withhold to Illinois after the taxpayer moved to another state.

- The Department generally uses what is shown on the Form W-2 as the correct Illinois wages and withholding. If the Illinois wages and/or withholding are incorrect, the auditor must be provided with a Form W-2C (corrected W-2) or an employer letter on company letterhead stating the correct amount of wages allocable to Illinois. A letter from the taxpayer's tax representative is not acceptable support. If the employer is unwilling or unable to supply the correct information, other proof of the correct amount of Illinois wages may be used.

(2) Line 15 –

This information is reported from federal Form 1040, Line 17, - rents, royalties, partnerships, S corporations, estates, and trusts.

- If income is received from an Illinois partnership or S corporation, that information should be provided on an Illinois Schedule K-1-P, Partner's or Shareholder's Share of Income, Deductions, Credits, and Recapture.

- If income is received from an Illinois estate or trust, that information should be provided on an Illinois Schedule K-1-T, Beneficiary's Share of Income and Deductions.

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(3) Line 17 –

Unemployment compensation, Alaska Permanent Fund dividends, and jury duty pay:
As a nonresident, these were not taxed by Illinois. **However**, with the passage of PA 97-0709 (effective July 1, 2012), unemployment compensation received from the Illinois Department of Employment Security is now allocable to this state for tax years 2012 and forward, which includes nonresidents receiving this compensation. Alaska Permanent Fund dividends and jury duty pay remain as not taxed by Illinois for nonresidents.

(4) Line 19 –

"Other income", which comes from the federal Form 1040 Other Income line (line number may vary based on year), requires careful scrutiny.

- Illinois Lottery winnings must be allocated to Illinois in Column B whether a part-year or nonresident (even if a resident of a reciprocal state). Other Illinois gambling is allocated to Illinois only if a taxpayer is a part-year resident who receives the income while he or she is a resident, but not if a nonresident.

- The amount received from the sale of Illinois State Lottery installment payments must be allocated to Illinois in Column B for tax years ending on or after December 31, 2013, whether a part-year or nonresident (even if a resident of a reciprocal state), but only amounts received by a part-year resident while he or she is a resident are allocated to Illinois for earlier years.

- Federal net operating losses (NOLs) are also reported on this line. For example, the taxpayer should record on this line a business net operating loss (NOL) from an earlier year that is being carried forward. If the loss was derived from

    - a partnership or an S corporation, the loss is allocated to Illinois to the same extent that business income from that entity is apportioned to Illinois on the Illinois Schedule K-1-P for this year.
    - a business conducted entirely within Illinois, the entire amount is allocated to Illinois.
    - a business conducted inside and outside Illinois, figure the Illinois portion on the IAF Worksheet found in the

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Schedule NR instructions, and include the amount from Line 3 of the worksheet

For further information on NOLs, refer to the Federal AGI section in this chapter, as well as 86 IAC § 100.2410.

b) Schedule NR Step 4

Once the Illinois portion of the federal adjusted gross income has been calculated, Step 4 of Schedule NR should be completed to determine the Illinois portion of allowed adjustments (both additions and subtractions).

- Column A is used to report the total amounts from Form IL-1040. The taxpayer is required to complete Lines 1 through 10 of the Form IL-1040, as if they were a full-year Illinois resident. Column A total amounts come from these reported Form IL-1040 figures.

- Column B is used to report the Illinois portion of the additions and subtractions. The Schedule NR step-by-step instructions should be followed when figuring each line for the Illinois portion. Instructions provided with Schedule K-1-P or K-1-T will also aid in the completion of this step.

c) Schedule NR Step 5

Step 5 of the Schedule NR will then be completed to determine the Illinois net income and the tax before recapture of investment credits.

- See Exhibit A – Schedule NR – Part-year Resident Example.
- See Exhibit B – Schedule NR – Nonresident Example.

XII. TAX

A. ILLINOIS RESIDENTS

Net income will be multiplied by the tax rate for that taxable year. Tax rates are provided for in IITA § 201(b). Also, see the reference chart in the General Information Section of this chapter.

B. NONRESIDENTS AND PART-YEAR RESIDENTS

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Schedule NR is used to determine Illinois Income Tax (before any recapture of investment credits for 2008). The last line of the tax calculation section of the schedule will be the tax amount (before recapture) that will be written on the Form IL-1040 for nonresidents and part-year residents.

C. RECAPTURE OF INVESTMENT TAX CREDITS

If an investment tax credit was claimed in a previous year, and the property considered in the computation of the investment credit was disqualified within 48 months after being placed in service, Schedule 4255, Recapture of Investment Tax Credits, must be completed for the recapture amount to be determined.

The investment tax credits affecting an individual (Form IL-1040) as found on the Schedule 4255 are:

1) The Enterprise Zone or River Edge Redevelopment Zone
2) The High Impact Business
3) The Angel Investment Credit – Note that this recapture applies if the investment is held less than three years. The 48 months as stated above does not apply to this credit.

RECAPTURE OF INVESTMENT TAX CREDITS

Credit	IITA §	IAC §
Enterprise Zone or River Edge Redevelopment Zone	201(f)	100.2110(g)
High Impact Business Investment	201(h)	100.2130(h)
Angel Investment	220(d)	100.2171(e)

1. TAX YEARS 2008 AND FORWARD

The total recapture amount from Schedule 4255 is carried over and entered on the Form IL-1040, Line 14 (recapture of investment tax credits) - no worksheet calculation is required as in previous tax years.

Step 6: Tax

13	***Residents:*** Multiply Line 11 by 3% (.03). Write the result here. ***Nonresidents and part-year residents:*** Write the tax before recapture of investment credits from Schedule NR.	13	.00
14	Recapture of investment tax credits. **Attach** Schedule 4255.	14	.00
15	**Total tax**. Add Lines 13 and 14. This amount may not be less than zero.	15	.00

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2. TAX YEARS PRIOR TO 2008

The total recapture amount from the Schedule 4255 will be carried to the Schedule 4255 Recapture Worksheet, where the Form IL-1040 tax can be calculated and then moved to the tax line on the Form IL-1040. Below is the worksheet as taken from the 2007 Form IL-1040 instructions:

Schedule 4255 Recapture Worksheet

Write the amount from Schedule 4255:

1 Step 4, Line 16, Column A.	1	
2 Step 4, Line 16, Column B.	2	
3 **Illinois residents** - Multiply Form IL-1040, Line 13, by 3% (.03). **Nonresidents or part-year residents**- Write Schedule NR, Line 56.	3	
4 Add Lines 1, 2, and 3. Write here and on Form IL-1040, Line 15.	4	

Attach **Schedule 4255 (not this worksheet).**

The appropriate Recapture worksheet can be found in the instructions of Form IL-1040 for each applicable year. Note that both the Schedule 4255 and the worksheet are year specific as to the line numbers. Whenever recapture of these investment credits is calculated, each year should be addressed with the appropriate Schedule 4255 and worksheet, if required.

Schedule 4255, Recapture of Investment Tax Credits, must be completed and attached to the Form IL-1040. The worksheet must be completed but is not a required attachment.

XIII. TAX AFTER NONREFUNDABLE CREDITS

For tax years **2008 and after**, credits have been divided into two sections- nonrefundable and refundable credits. The nonrefundable credits are as follows:

A. CREDIT FOR INCOME TAX PAID TO OTHER STATES

Residents and part-year residents who pay income tax on income both in Illinois and another state or states can claim a credit against this “double-taxed income.” Nonresidents may not claim this credit. IITA § 601(b)(3) provides the basis for this credit.

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86 IAC § 100.2197(b) addresses the definitions needed for the credit.

- The qualified tax for this credit must be "imposed upon or measured by income" which is paid by an Illinois resident (or part-year resident during the taxpayer's Illinois residency) and paid to another state on income which is also subject to Illinois income tax.

- The qualified income that is included in the other state's tax base must be part of Illinois base income according to IITA § 203.

- The other states may be any state of the U. S., Puerto Rico, any U.S. territory or possession, Washington D. C., or any political subdivision of the aforementioned. "State" does not mean any foreign nation or a political subdivision of that country. That distinction is important because sometimes taxpayers do try to claim the Schedule CR credit on foreign-taxed income.

1. SCHEDULE CR, CREDIT FOR TAX PAID TO OTHER STATES

The Schedule CR form guides the taxpayer in the amounts to consider in determining the eligible credit. This credit is the most complex in calculating, especially if the taxpayer is taxed by multiple states, has multiple components of income and deductions, and/or is only a part-year resident.

The auditor will find it useful to review 86 IAC § 100.2197, Publication 111 that provides the equivalency chart for the specific year/states in question, and the Schedule CR form and instructions for that specific tax year.

2. SCHEDULE CR, 2009 AND FORWARD

The format of the Schedule CR changed significantly for years 2009 and forward. For those years, the limit on the credit is equal to the Illinois tax multiplied by a fraction equal to the taxpayer's base income that would be sourced to other states if all states used Illinois' allocation and apportionment rules, divided by total base income. How much income is actually sourced to other states using their allocation and apportionment rules is totally irrelevant. The form is set up similarly to the Schedule NR, where there are two columns; lines are identified for each federal and Illinois income and deduction component as they appear on each respective return.

- Column A represents the income from all sources received by the taxpayer while he or she was a resident. For full-year residents, Column A, Step 2 will match the federal return.

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- Column B represents the portion of Column A income earned outside of Illinois during the period he or she was a resident, determined using Illinois allocation and apportionment rules.

One recurring problem taxpayers have is with the sourcing of employee compensation. For employees providing services in multiple states, Illinois sources all employee compensation to one state, usually the state in which the employee's base of operations is located. For residents, this is usually in the state of residence, so that none of the employee compensation should be included in Column B. However, many taxpayers will include employee compensation in Column B if it is taxed by another state, even though that is incorrect. A similar problem occurs with gambling winnings (other than state lottery winnings), which Illinois sources to the state of residence. This means that none of the winnings should be included in Column B even when they are from another state's casino and the other state taxes them.

- See Exhibit C – How to Complete Schedule CR – 2010 Example

3. SCHEDULE CR, 2008 AND PRIOR

For tax years prior to 2009, the limit on the credit is equal to the Illinois tax multiplied by a fraction equal to the taxpayer's base income that is taxed by both Illinois and another state, divided by the total base income. This determination is extremely complicated and requires careful attention to the Publication 111 for the taxable year. Also, employee compensation again has special treatment for most periods:

Tax Years Beginning 1/1/06

86 IAC § 100.2197(b)(4), which addresses compensation, marked a major change in calculating the Schedule CR credit. Beginning 1/1/06, compensation paid in this state which is received by a resident and double-taxed can be considered for the Schedule CR credit.

Tax Years Prior to 1/1/06

For taxable years beginning prior to 1/1/06, no compensation "paid in Illinois" could be claimed for the Schedule CR credit, even if it was double-taxed by another state. Ref: IITA Section 601(b)(3).

Note: Several examples on determining "double-taxed income" can be found in 86 IAC § 100.2197(b)(4).

The auditor must take care in particular with part-year residents, especially when the taxpayer is taxed in several states. It may not be possible to verify from the returns and the Schedule CR what the correct double-taxed income is, and the taxpayer should

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provide any additional documentation, schedules, and income break-downs to assist the auditor in determining the correct credit.

To assist taxpayers with determining the correct double-taxed income includable in Illinois base income and the associated tax, Publication 111 was created. It provides Comparison Formulas to determine the income equivalent to enter on the Schedule CR, Column B that is double-taxed income, and tax equivalent to enter on the Schedule CR, Column C. Comments for special rules are also included. Note below the 2006 Comparison Formula for Indiana:

Comparison Formulas for Schedule CR
Information is based on 2006 forms and Regulation Section 100.2197

State	Necessary Attachments to CR Schedule	Income Equivalent to Enter in Schedule CR, Column B	Tax Equivalent to Enter in Schedule CR, Column C	Comments
Indiana	IT-40PNR Schedule A Schedule D	IT-40PNR, Line 3 **Plus** Schedule D, Lines 1, 2, 9, and any human services deduction (#605), Indiana partnership long-term care policy premiums deduction (#608), and medical savings contributions (#612) on Line 11 **Minus** Schedule A, Line 24B **Minus** any valuation limitation or ridesharing income on IL-1040, Line 9, and included in IT-40PNR, Line 3,	IT-40NPR Line 17 **Minus** Lines 14, 15, 16, 21, 22, 23, 24, and 25	

- Formulas are provided for each state and are available on the IDOR website under Publication 111, which go back to 2002.
- For forms 1997-2008 available on the IDOR website, the form changed little, and the credit was essentially calculated in this same fashion.
- The taxpayer must compute the double-taxed income and associated tax being claimed for each state based on these formulas, and the auditor should use the formulas to determine the allowable credit.

See Exhibit D – How to Complete Schedule CR – 2006 Example

- The taxpayer may claim a local tax (county, city, local) on earnings that is double-taxed. Wages are the common form of income where this is an issue.
    - The taxpayer will have a tax imposed on the same wages by another state and a municipality within that state. The taxpayer is entitled to claim the taxes paid on Illinois base income for the other state and municipality but may only claim the higher of double-taxed wages for the same income. The taxpayer must provide a local tax return, or if one is not required, a copy of the W-2 showing income taxed and paid.

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Local Tax Examples

Example 1: Mr. Smith filed a 2006 Schedule CR with a Missouri return and a W-2, claiming double-taxed wages of $73,000 for Column B and income tax paid of $2,700 for Column C of the 2006 Schedule CR. The Missouri return is included with a Missouri W-2. Publication 111 and the W-2 both only support Missouri wages taxed and allowable of $70,500 and Missouri state tax paid of $2,200. However, the W-2 included local wages (St. Louis) of $73,000 taxed and $500 in local tax withheld. The taxpayer can claim the higher of the double-taxed wages ($73,000), and the local taxes paid ($500) plus the allowable state taxes paid ($2,200), so the amounts originally claimed by Mr. Smith would be correct.

Example 2: Ms. Smith filed a 2008 Schedule CR claiming double-taxed local wages for Louisville, Kentucky. While state income tax on wages is disallowed for the Schedule CR credit because of the reciprocal agreement for Kentucky, local taxes paid on double-taxed wages can be claimed. No Louisville return was required to be filed, but Ms. Smith provided a 2008 W-2 identifying $140,000 in wages and $2,100 in taxes paid to Louisville. These amounts should be allowed on Columns B and C of the Schedule CR.

B. ILLINOIS PROPERTY TAX CREDIT

IITA § 208 established the Illinois Property Tax Credit. Beginning with tax years ending on or after December 31, 1991, every individual taxpayer shall be entitled to a tax credit equal to 5% of real property taxes paid by such taxpayer during the taxable year on the principal residence of the taxpayer. 86 IAC § 100.2180(b) and (c) further clarifies this credit. Also, see Publication 108, Illinois Property Tax Credit for additional information.

This property tax credit applies only to Illinois residents and part-year residents. A credit for the Illinois property taxes paid may be figured on the taxpayer's principal residence (not a vacation home or rental property). When figuring the credit, property tax you paid on an adjoining lot to your principal residence can be included, if it is used for residential purposes. These taxes apply to the time the residence was owned and lived in during the previous tax year. For example, property taxes paid in 2010 would apply to the time the resident owned and lived in the home during 2009.

Note: Changes to the Illinois Property Tax Credit through PA 100-022:
For tax years beginning on or after January 1, 2017, the Illinois Property Tax Credit is not allowed if the taxpayer's adjusted gross income for the taxable year exceeds $500,000 for returns with a federal filing status of married filing jointly, or $250,000 for all other returns.

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The auditor should also review Publication 108, Illinois Property Tax Credit, which provides an explanation of the credit and what expenditures are eligible towards calculating the credit. This is available at: http://tax.illinois.gov/Publications/Pubs/Pub-108.pdf

Although the computation and amount of credit has remained essentially the same since its inception, how the credit is reported has changed. These changes can be viewed for periods of 2007 and prior, 2008, and 2009 forward.

1. PROPERTY TAX (PT) WORKSHEET (FOR USE IN TAX YEARS 2007 AND PRIOR)

Illinois residents and part-year residents must complete the Homeowner's Property Tax (PT) Worksheet to determine the credit amount if they are eligible for this property tax credit. The appropriate property tax worksheet can be found in the instructions of Form IL-1040 for each applicable year. Below (as an example) is the worksheet taken from the 2007 Form IL-1040 instructions:

Homeowner's Property Tax (PT) Worksheet

You must complete this worksheet if you are eligible for the Illinois Property Tax credit. Nonresidents may not claim this credit.

1	Illinois property tax **paid** in **2007** for the real estate that includes your principal residence			1
2	Portion of your tax bill that is deductible as a business expense on U.S. Schedule C, E, or F or other U.S. income tax forms or schedules, whether or not you actually took the federal deduction			2
3	Subtract Line 2 from Line 1. Write this amount on **Line 20a** of your Form IL-1040.			3
4	Multiply Line 3 by 5% (.05).			4
5	Income tax from Form IL-1040, Line 16	5		
6	Credit for tax paid to other states from Form IL-1040, Line 19	6		
7	Subtract Line 6 from Line 5.			7
8	Compare the amounts on Line 4 and Line 7. Write the lesser amount here and on Form IL-1040, **Line 20b**. This is your Illinois Property Tax Credit.			8

Note **Be sure to keep this worksheet, proof of your property tax paid, and copies of any closing statements with your income tax records. You must submit this information to us if we request it.**

This worksheet was not required to be attached to the return, and the credit was simply recorded on the return, along with the qualified property taxes paid. Since the only refundable credit is the Earned Income Credit, the worksheets and schedules are designed to reduce the credits so that they do not exceed the tax due.

The following is the order of importance for credits being reduced: Schedule CR credit, Property Tax credit, Schedule ED credit, and 1299-C credit. This means that the 1299-C credits will be applied only after the first three have been applied to the tax, the ED credit after the first two are applied to the tax, and the Property Tax is applied after any Schedule CR credit is applied. Therefore, the Property Tax Worksheet above shows that the credit allowed is the lesser of the Lines 4 and 7, which takes into account the tax due reduced by any Schedule CR credit.

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On the 2007 Form IL-1040, the qualified property taxes paid are recorded on Line 20a), and the allowable credit is recorded on Line 20b) shown below:

20 Illinois Property Tax credit. **Complete PT Worksheet in instructions.**
PT Worksheet Line 3 amount 20a
PT Worksheet Line 8 amount 20b

2. PROPERTY TAX CREDIT (2008)

Beginning tax year 2008, the **Schedule ICR** was introduced. This new form combined the reporting of three credits: Property Tax, Education Expense, and Earned Income Credit (EIC). Property Tax and Education Expense are both nonrefundable credits, while EIC is a refundable credit. To claim these credits, Schedule ICR must be completed and attached to the Form IL-1040. Section A of the Schedule ICR is for reporting the Property Tax Credit, which is still computed in the same fashion as prior years (2007 and earlier). Note Section A of the 2008 Schedule ICR:

Section A - Illinois Property Tax Credit

4 a Write the total amount of Illinois Property Tax paid during the tax year for the real estate that includes your principal residence. 4a
b Write the portion of your tax bill that is deductible as a business expense on U.S. income tax forms or schedules, even if you did not take the federal deduction. 4b
c Subtract Line 4b from Line 4a. 4c
d Multiply Line 4c by 5% (.05). 4d
5 Compare Lines 3 and 4d, and write the lesser amount here. 5
6 Subtract Line 5 from Line 3. 6

3. PROPERTY TAX CREDIT (STARTING IN 2009)

Starting in tax year 2009, the taxpayer is required to provide the Property Index Number (PIN) for the principle residence and any adjoining lots being claimed. Note the modified form below:

Section A - Illinois Property Tax Credit (See instructions for directions on how to obtain your PIN)

4 a Write the total amount of Illinois Property Tax paid during the tax year for the real estate that includes your principal residence. 4a
b Write the Property Index Number (PIN) for the property listed above. 4b
c Write the PIN for an adjoining lot, if included in Line 4a. 4c
d Write the PIN for any other adjoining lot, if included in Line 4a. 4d
e Write the portion of your tax bill that is deductible as a business expense on U.S. income tax forms or schedules, even if you did not take the federal deduction. 4e .00
f Subtract Line 4e from Line 4a. 4f .00
g Multiply Line 4f by 5% (.05). 4g .00
5 Compare Lines 3 and 4g, and write the lesser amount here. 5 .00
6 Subtract Line 5 from Line 3. 6 .00

New PIN lines

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The "PIN" number often referred to as the "parcel number" or "permanent number", should be located on the property tax bill or assessment notice. If the taxpayer pays property tax through a mortgage, the mortgage statements will probably not identify the PIN number, and the taxpayer should contact their lender or county assessor's office.

4. PROPERTY TAX CREDIT (STARTING IN 2013)

Starting in tax year 2013, the taxpayer is required to also provide the County in which the property is located.

Section A - Illinois Property Tax Credit (See instructions for directions on how to obtain your property number)

4 a Write the total amount of Illinois Property Tax paid during the tax year for the real estate that includes your principal residence. 4a _____ .00

b Write the county and property number for the property listed above.

4b _____ County _____ Property number

c Write the county and property number for an adjoining lot, if included in Line 4a.

4c _____ County _____ Property number

d Write the county and property number for another adjoining lot, if included in Line 4a.

4d _____ County _____ Property number

New County lines added

e Write the portion of your tax bill that is deductible as a business expense on U.S. income tax forms or schedules, even if you did not take the federal deduction. 4e _____ .00

f Subtract Line 4e from Line 4a. 4f _____ .00

g Multiply Line 4f by 5% (.05). 4g _____ .00

5 Compare Lines 3 and 4g, and write the lesser amount here. 5 _____ .00

6 Subtract Line 5 from Line 3. 6 _____ .00

Audit Issues

1) When auditing this credit, a PIN number with property tax written on the Schedule ICR does not substantiate the credit being claimed. The taxpayer must be able to provide the documentation to support this credit if requested, such as the property tax bill and record of payment.

2) Another audit concern is with a taxpayer who files as "married filing separately". If the spouse is also an Illinois filer, the auditor must verify that the taxpayer and spouse are not claiming the same credit amount. The two filers can divide the credit in any portion they wish, but they cannot claim an amount that exceeds the total allowable credit as if they filed jointly. This is true for all of the Illinois credits.

Example: Taxpayer A, files "married filing separately" and claimed a property tax credit of $500 on a qualified property tax paid of $10,000 for property X. Taxpayer B, the spouse of Taxpayer A, also filed "married filing separately" and claimed a property tax credit of $500 on a qualified property tax paid of $10,000 for property X. Both taxpayers may divide the $500 any way they wish

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between themselves but may not claim together more than the allowable $500. For instance, the two could both claim a credit of $250.

3) Circumstances may arise where each spouse maintains a separate principal residence, which may be due to their career requirements, a pending divorce, or another justifiable reason. This would allow the credit to be claimed for two properties on a joint return and for each spouse to claim the credit on his or her principal residence on a married filing separate return. This situation is referenced in Publication 108.

When two residences are claimed on a joint return, the taxpayers must support the claim with appropriate documentation. The 2012 Schedule ICR specifically instructs the taxpayers to identify the PIN for the second property on Line 4c if both property tax amounts were included on Line 4a.

C. K-12 EDUCATION (ED) EXPENSE CREDIT

A nonrefundable credit for qualified education expenses may be claimed by parents or guardians according to IITA § 201(m), while 86 IAC § 100.2165 defines and explains the key terms and provisions of the credit. Also, see Publication 119, Education Expense Credit General Rules and Requirements for Home Schools, and Publication 132, Education Expense Credit General Rules and Requirements for Parents and Guardians, for additional information.

To generally summarize the credit, it is a credit for qualified expenses incurred by parents or guardians in excess of $250 for the pupil during the regular school year. The final credit may not exceed $500 for tax years ending before December 31, 2017 (see Note below as to the increase to $750). The credit is computed by multiplying the qualifying expenses in excess of $250 times 25%. This determination is compared to $500, and then the lesser amount is allowed as the education expense credit.

Example: In 2015, the taxpayer incurred $2,000 in qualified education expenses (tuition and lab fees) during the regular school year on behalf of a pupil. In calculating the credit, Taxpayer cannot claim the first $250 in expenses, so she subtracts $250 from $2,000. Then, she multiplies the remainder, $1,750 times 25%, which equals $437.50, which will be allowed as the education expense credit.

Total Incurred Expenses	Qualified Expense Amount	Allowed Expense Credit
$2,000	$2,000 - $250= $1,750	$1,750 X 0.25= $437.50

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Note: Changes to the K-12 Education Expense Credit through PA 100-022:
For tax years ending on or after December 31, 2017, the maximum amount of the K-12 Education Expense Credit has been increased to $750 per family. The K-12 Education Expense Credit is not allowed if the taxpayer's adjusted gross income for the taxable year exceeds $500,000 for returns with a federal filing status of married filing jointly, or $250,000 for all other returns.

See additional examples in 86 IAC § 100.2165(b)(4)(C) in evaluating and determining the Education Expense Credit.

1. K-12 EDUCATION (ED) EXPENSE CREDIT (TAX YEARS 2008 AND FORWARD)

Like the Property Tax credit, for tax years 2008 and forward, the education expense credit is recorded on the Schedule ICR under Section B, shown below:

Section B - K-12 Education Expense Credit

Note You must **attach** the receipt you received from your students' school or complete the ***K-12 Education Expense Credit Worksheet*** on the back of this schedule.

7	a	Write the total amount of K-12 education expenses from the receipt you received from your students' school or Line 13 of the worksheet on the back of this schedule.	7a	
	b	You may not take a credit for the first $250 paid.	7b	250.00
	c	Subtract Line 7b from Line 7a. If the result is negative, enter "zero."	7c	
	d	Multiply Line 7c by 25% (.25). Compare the result and $500, and write the lesser amount here.	7d	
8		Compare Lines 6 and 7d, and write the lesser amount here.		8

If the taxpayer has a complete Qualified ED receipt, then it should be attached to the back of the Schedule ICR. If the taxpayer did not receive a Qualified ED receipt, then the ED worksheet (which now resembles the former Schedule ED) should be completed on page two of the Schedule ICR. Tax year 2010 requires that the taxpayer complete the ED worksheet on the Schedule ICR and attach the Qualified ED receipt if received.

2. K-12 EDUCATION EXPENSE CREDIT WORKSHEET (TAX YEARS 2007 & PRIOR)

To determine the credit for education expenses when the taxpayer has received a school receipt of expenses, the K-12 Education Expense Credit (ED) Worksheet must be completed, and the school receipt must be attached to the Form IL-1040.The appropriate worksheet can be found in the instructions of Form IL-1040 for each applicable year. Below is the worksheet taken from the 2007 Form IL-1040 instructions:

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K-12 Education Expense Credit (ED) Worksheet

Complete this worksheet only if you received a receipt from the school. Otherwise, complete Schedule ED.

1	**Total amount** of qualified expenses you paid during 2007 from your receipt. If less than $250, stop here. If greater than $250, write the amount here and on **Line 21a** of your Form IL-1040.		1	
2	You may **not** take a credit for the first $250 paid for your family's education expenses.		2	$250 00
3	Subtract Line 2 from Line 1.		3	
4	Multiply the amount on Line 3 by 25% (.25).		4	
5	Income tax from Form IL-1040, Line 16		5	
6	Credit for tax paid to other states from Form IL-1040, Line 19	6		
7	Property tax credit from Form IL-1040, Line 20b	7		
8	Add Lines 6 and 7.		8	
9	Subtract Line 8 from Line 5.		9	
10	Compare the amount on Line 4, the amount on Line 9, and $500. Write the lowest amount here and on your Form IL-1040, **Line 21b**. This is your education expense credit.		10	

Note **Be sure to keep this worksheet with your income tax records. However, you must attach the receipts you received from the school to your Form IL-1040.**

Schedule ED (for Use in Tax Years 2007 and Prior)

To determine the education expenses when no expense receipt is obtained from the school, Schedule ED, Credit for K-12 Education Expenses, must be completed and attached to the Form IL-1040. To access Schedule ED for the appropriate year, go to the link that follows then select the desired year, then Schedule ED: http://tax.illinois.gov/taxforms/prioriit.htm

Audit Issues

1) A common problem with the Qualified ED receipts is that they do not contain all the information that is required as explained in Publication 112, which is located at http://tax.illinois.gov/Publications/Pubs/Pub-112.pdf. Often, the schools will not include the SSN or grade level of student. This is not acceptable as the form must contain all of the required information as listed in PUB 112, or the taxpayer should provide a completed Schedule ED.

2) When a taxpayer home schools children, Schedule ED must be completed and any receipts that are applicable to home school education should be retained for the tax year. Taxpayers must provide the auditor with sufficient documentation to substantiate qualified education expenses incurred, which should clearly identify the type of expense and its payment. The taxpayer is instructed by the Form IL-1040 to complete a Schedule ED and attach the receipts.

3) An audit situation could arise where the custodians file separately. Although both custodians could split the eligible credit according to the qualified expenses incurred, they are not allowed to both claim expenses

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incurred by the other custodian or in total more than the allowable credit, or "double-dip".

Example: Taxpayer A and Taxpayer B file "married filing separately" and both incurred $5,000 each for qualified expenses on behalf of their child. Since ($10,000-$250) X .25= $2437.50, the maximum credit they could claim in total is $500. However, both taxpayers claimed $500 each (or $1,000 in total) for one qualified pupil. The credit should be disallowed for the taxpayer under audit, and the spouses will have to prorate the credit and file amended returns to claim the proper credit.

4) Although the credit is allowed for kindergarten expenses, the credit is allowed only for attendance at a school that meets the requirements of the truancy laws. Prior to the 2014-15 school year, attendance at a kindergarten was not mandatory, only grades 1 through 12 were mandatory. Accordingly, kindergarten attendance at a school that did not include higher grades would not qualify for the credit. For the 2014-15 school year and subsequent years, attendance at kindergarten is mandatory for 5-year-olds, and the credit is allowable for schools that provide only kindergarten and pre-kindergarten classes.

D. CREDIT AMOUNT FROM SCHEDULE 1299-C

Schedule 1299-C, Income Tax Subtractions and Credits for individuals, is used to determine the following amounts:

1) Total dividend subtraction allowed for the Schedule M line pertaining to Enterprise Zone (or River Edge Redevelopment Zone) and High Impact Business (within a Foreign Trade Zone or sub-zone) and

2) Total credit allowed for taxpayers who are eligible for credits on Schedule 1299-C.

Note: For tax year 2018, major changes were made to Schedule 1299-C. Also new for tax year 2018 is the Schedule 1299-I, Income Tax Credit Information to be used with Schedule 1299-C.

Most of the subtractions and credits on the Schedule 1299-C also appear on Schedules 1299- A, B, and D, which are used by businesses, and the format of the Schedule 1299-C also resembles those other forms.

- The Schedule 1299-C instructions provide a description and required attachments for each credit. Each subtraction or credit is calculated on the Schedule 1299-C.

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- It is important to realize that changes occur frequently, sometimes yearly, to the Schedule 1299-C, and the auditor should refer to the form instructions.

- The instructions for the Form IL-1040 in the "What's New" section would also highlight any 1299-C changes for that year.

1. SUBTRACTIONS

The subtractions will be reported on Schedule M. For tax years starting 2013, the Enterprise Zone Dividend Subtraction has been eliminated.

2. CREDITS

Unlike the other individual credits, the 1299-C credits can be carried forward.

- The first two credits listed, TECH-PREP Youth Vocational Programs Credit and Dependent Care Assistance Program Credit, are carried forward two years.

- The remainder, Film Production Services Tax Credit through New Markets Credit, can be carried forward five years.

- Step 5 of the Schedule 1299-C is to be completed by the taxpayer in order to properly carry the credits. The auditor should review the credits to make sure that they were carried properly.

See Exhibit E – Schedule 1299-C, Step 5 (2013 tax year)

For the taxpayer to properly claim 1299-C subtractions and credits, the Schedule 1299-C and any supporting documents must be attached to the Form IL-1040. When performing an audit, the Schedule 1299-C taxpayer information may be found in GenTax by the auditor.

See Exhibit F – Schedule 1299-C in GenTax – 2013 tax year

The following table lists Schedule 1299-C Income Tax Subtractions and Credits and their legislative source, which should be cited for any discrepancy with the taxpayer and referenced for further details of each credit beyond the Schedule 1299-C instructions. New for tax year 2018 is the Schedule 1299-I, Income Tax Credit Information to be used with the 1299-C.

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	Subtractions (figured on Schedule 1299-C but reported on Schedule M)	Legislative Source	Pass-through
1	Enterprise Zone or River Edge Redevelopment Zone Dividend Subtraction	IITA § 203(a)(2)(J)	Yes
2	High Impact Business Dividend Subtraction (within a Foreign Trade Zone or sub-zone)	IITA § 203(a)(2)(K)	Yes
	Credits from Schedule 1299-C		
1	TECH-PREP Youth Vocational Programs Credit	IITA § 209	No
2	Dependent Care Assistance Program Credit	IITA § 210	No
3	Film Production Services Tax Credit	IITA § 213	Yes
4	Jobs Tax Credit (repealed by PA 98-0109)	IITA § 201(g)	No
5	High Impact Business Investment Credit	IITA § 201(h)	No
6	Enterprise Zone or River Edge Redevelopment Zone Investment Credit	IITA § 201(f)	Yes
7	Economic Development for a Growing Economy (EDGE) Tax Credit	IITA § 211	Yes
8	Tax Credit for Affordable Housing Donations	IITA § 214	Yes
9	Research and Development (R&D) Credit (1)	IITA § 201(k)	Yes
10	River Edge Redevelopment Zone Remediation Credit	IITA § 201(n)	No
11	Ex-Felons Jobs Credit	IITA § 216	Yes
12	Veterans Jobs Credit – qualified veterans*/qualified unemployed veterans	IITA § 217/217.1	Yes
13	Student-Assistance Jobs Credit	IITA § 218	Yes
14	New Markets Credit	20 ILCS 663/	Yes
15	Angel Investment Credit	IITA § 220	Yes
16	River Edge Historic Preservation Credit	IITA § 221	Yes
17	Live Theater Production Tax Credit	IITA § 222	Yes
18	Hospital Credit	IITA § 223	Yes
19	Historic Preservation Credit (2)	IITA § 219	Yes
20	Invest in Kids Credit	IITA § 224	Yes
21	Instructional Materials & Supplies Credit	IITA § 225	No
22	Natural Disaster Credit	IITA § 226	Yes
23	Adoption Credit	IITA § 227	No

Notes: The Jobs Tax Credit was repealed by Public Act 98-0109. The Enterprise Zone Dividend Subtraction has been eliminated by Public Act 97-0905. Both have been removed

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from Schedule M and Schedule 1299-C starting in tax year 2013. For tax year 2012, the Enterprise Zone Dividend Subtraction could only be claimed for those dividends received prior to August 7, 2012.

* The sunset date for the Veterans Jobs Credit for "qualified veterans" was January 1, 2015. This credit should not be claimed for tax years beginning on or after January 1, 2015. However, the credit for "qualified unemployed veterans" is still allowed, as it is not affected by this sunset date.

(1) – R&D Credit – this credit expired with a sunset date of "for tax years ending prior to January 1, 2016", but due to changes through PA 100-022, the Research and Development Credit has been reinstated and is retroactive for the 2016 tax year. This credit has been extended through tax years ending prior to January 1, 2027 by PA 101-0207.

(2) – Historic Preservation Credit – this credit has expired with a sunset date of "for tax years ending on or before December 31, 2015".

3. PASS-THROUGH INCOME

If a partnership or S corporation qualifies for either the dividend subtractions or certain credits, any distributive share of income is passed on to or flows-through to the partners or shareholders. The subtractions and credits that can flow-through are noted in the above chart by "Yes" in the pass-through column.

There are a few credits that individuals qualify for and pass-through entities do not, such as the Jobs Tax Credit. Likewise, there are some credits on the Schedule 1299-A for pass-through entities that cannot be claimed by the individual on the 1299-C, such as Historic Preservation Credit.

- If the credit does not appear on the 1299-C, it is not allowable, even if it was reported to the taxpayer on his Schedule K-1-P. For any pass-through subtraction or credit, the taxpayer must have Schedule K-1-P(s) to support any distributive share of subtraction or credit.

XIV. OTHER TAXES

A. HOUSEHOLD EMPLOYMENT TAX (TAX YEARS 2011 AND FORWARD)

Starting in tax year 2011, if Illinois Income Tax was withheld from a household employee, Form IL-1040 could be used to report and pay the tax withheld. Household employers who filed annually in past years on Form UI-WIT, Combined Return for Household Employees,

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should use Form IL-1040 to report Illinois Income Tax withheld starting in 2011. Form UI-WIT is no longer available.

If household employee withholding was already reported or paid using Form IL-941, Illinois Withholding Income Tax Return, or Form IL-501, Payment Coupon, it should not be reported on the Form IL-1040.

B. USE TAX (TAX YEARS 2010 AND FORWARD)

Starting in tax year 2010, if a taxpayer owes $600 or less in use tax for that tax year, it may be reported and paid on the Form IL-1040 rather than with the filling of Form ST-44, Illinois Use Tax Return.

Public Act 096-1388 established that for taxable years ending on or after 12/31/2010, the Department was required to put a line on the Form IL-1040 return for Use Tax. The intention was to follow other states that have done the same and make Illinois citizens aware of their requirement to file and pay Use Tax. This also could facilitate compliance by allowing the taxpayer to pay the Use Tax with income tax, as opposed to filing a separate Form ST-44.

1. WHAT IS ILLINOIS USE TAX?

Illinois Use Tax is a sales tax that the purchaser owes on items that are bought for use in Illinois. If the seller does not collect this tax, the purchaser must pay the tax to the Illinois Department of Revenue (IDOR). The most common purchases on which the seller does not collect Illinois Use Tax are those made via the internet, from a mail order catalog, or made when traveling outside Illinois.

2. WHEN MUST ILLINOIS USE TAX BE PAID TO IDOR?

One must pay Illinois Use Tax to IDOR if

- the items bought are taxable in Illinois,
- the items are used or consumed in Illinois, and
- when the items were purchased either
    - no sales tax was paid to the seller, or
    - paid sales tax was less than Illinois' Use Tax rates of 6.25 percent for general merchandise and 1 percent for food and drugs.

Examples - If the taxpayer purchased:

- a computer over the internet for use in Illinois and paid no sales tax, 6.25 percent Illinois Use Tax is owed.

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- jewelry while vacationing in Georgia upon which 4 percent sales tax was paid and which was brought back to Illinois, Illinois Use Tax on the 2.25 percent difference in tax rates is owed.
- cheese by mail order from a company in Wisconsin and paid no sales tax, 1 percent Illinois Use Tax is owed.

3. INDIVIDUAL USE TAX AMNESTY

An Individual Use Tax Amnesty was in effect for taxpayers for purchases made from 7/1/04 through 12/31/10. To participate, the taxpayer had to file an ST-44 for each year in which there was Use Tax liability, writing "Amnesty" in red at the top of each form. These returns had to be filed and paid during the period of 1/11/11 through 10/15/11 to qualify for abatement of penalty and interest. If the taxpayer was unsure of the amount of purchases, the table below could be used to estimate the amount (the same Use Tax table in the 2010 Form IL-1040 Instructions):

If your AGI (IL-1040, Line 1) is	Column A this is your estimated purchases for ST-44, Line 1a	Column B this is your estimated use tax for ST-44, Line 1b
$0 - $10,000	$48	$3
$10,001 - $20,000	$144	$9
$20,001 - $30,000	$240	$15
$30,001 - $40,000	$336	$21
$40,001 - $50,000	$432	$27
$50,001 - $75,000	$608	$38
$75,001 - $100,000	$832	$52
>$100,000	Multiply AGI by .0096	Multiply Column A by .0625

Again, for 2010 purchases of $600 or less, the Use Tax should be reported on the Form IL-1040 for Amnesty purposes, and no penalty or interest will be assessed. Prior years and 2010 purchases greater than $600 must be reported on separate ST-44 forms.

C. COMPASSIONATE USE OF MEDICAL CANNABIS PILOT PROGRAM ACT SURCHARGE

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Starting in tax year 2014, the Medical Cannabis Surcharge has been added to the Form IL-1040 under the "Other Taxes". If the taxpayer has federal income attributable to transactions subject to the Compassionate Use of Medical Cannabis Pilot Program Act Surcharge they must complete the worksheet in the IL-1040 Instructions to determine the amount of their surcharge. The amount of the surcharge is equal to the amount of federal income tax liability for the taxable year attributable to the transactions subject to the surcharge. The surcharge is imposed on any taxpayer who incurs a federal income tax liability on the income realized on a "transaction subject to the surcharge," including individuals and other taxpayers who are not themselves the "organization registrant" that engaged in the transaction. A line has been included on Schedules K-1-P and K-1-T to identify the amount of federal income attributable to transactions subject to the surcharge that was passed through to you on federal Schedule K-1. See the 2014 Form IL-1040 instructions for complete details on the determination of this surcharge amount.

Note: Amended by PA101-363, effective 8/9/2019, which deletes "pilot" from references in the Compassionate Use of Medical Cannabis Pilot Program Act.

XV. PAYMENTS AND REFUNDABLE CREDIT

For tax years **2008 and after**, credits have been divided into two sections- nonrefundable (see earlier Section XIII) and refundable credits. The refundable credit (Earned Income) is included with the payments in this section of the Form IL-1040.

A. ILLINOIS INCOME TAX WITHHELD

Total Illinois Income Tax withheld is shown on the taxpayer's W-2 Form, Wage and Tax Statement. This amount is normally found in Box 17, state income tax.

- The taxpayer must also include any Illinois Income Tax withheld on Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., Form 1099-G, Certain Government Payments, and Form W-2G, Certain Gambling Winnings. A copy of any W-2, 1099-R, and W-2G must be attached to the Form IL-1040.

Missing W-2

A taxpayer can provide the auditor with a signed Form IL-4852, Substitute for Unobtainable Form W-2, to support the claimed withholding (a completed, signed, federal Form 4852 is also acceptable). This form can be obtained on the Department's website under the forms for Individuals (for that specific tax year).

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- The taxpayer must attach copies of paystubs or a letter from the employer on company letterhead supporting the wages and withholding being claimed. The IL-4852 alone without the paystubs or employer letter is not sufficient to support withholding claimed.

1. TAX YEARS 2009 AND FORWARD

For tax years 2009 and forward, the share of tax paid on behalf of the taxpayer through the Form IL-1023-C should not be included on the Illinois withholding line, but instead it is entered on the line for pass-through entity tax payments (see Section C below).

Note: For tax years ending on or after December 31, 2013, Form IL-1023-C and Form IL-1000 are both obsolete forms. Amounts previously reported on these forms will be reported on Form IL-1065, Form IL-1120-ST or Form IL-1041. Payment information will then be "passed-through" to the partner, shareholder, or beneficiary as a pass-through entity payment.

2. TAX YEAR 2008

If income from a partnership or S corporation was included on a Form IL-1023-C, Illinois Composite Income and Replacement Tax, the share of taxes paid on the taxpayer's behalf could be entered on the Illinois Income Tax withheld line. In order to receive credit for these payments, a copy of the Schedule K-1-P or K-1-T showing these payments had to be attached to the Form IL-1040.

3. TAX YEARS 2007 AND PRIOR

If income from a partnership or S corporation was included on a Form IL-1023-C, the share of taxes paid on the taxpayer's behalf could not be entered on the Illinois Income Tax withheld line unless the Department of Revenue gave written permission to do so. If written permission was provided, a copy of the Form IL-1023-C, a copy of Schedule K-1-P and a copy of the written permission had to be attached to the Form IL-1040 for the share of taxes to be allowed.

B. ESTIMATED INCOME TAX PAYMENTS (ES PAYMENTS)

The total of any payments made with Form IL-1040-ES, Estimated Income Tax Payments for Individuals, Form IL-505-I, Automatic Extension Payment for Individuals, and any overpayment that was credited from the previous year will be recorded on this line of Form IL-1040.

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1. ESTIMATED PAYMENTS (FORM IL-1040-ES)

IITA § 803(a) established the requirement to make ES payments (Form IL-1040-ES) for individuals. For taxable years ending before December 31, 2001, estimated payments are required to be paid if the estimated tax amount payable is expected to be more than $250. For taxable years ending on or after December 31, 2001, estimated payments are required if the estimated tax amount payable is more than $500. For taxable years ending on or after December 31, 2019, estimated payments are required if the estimated tax amount payable is more than $1,000 [not applicable to estates, trusts, partnerships, Subchapter S corporations, and farmers].

IITA § 803(d) provides the due dates for four equal installments:

- 1st April 15
- 2nd June 15
- 3rd September 15
- 4th January 15 of the following taxable year

- The taxpayer must either pay 90% of the liability shown on the current year's tax return, or 100% of the liability shown on the prior year's return. If the taxpayer earns income unevenly, the taxpayer has the option to annualize their income for purposes of estimated payments, which must be done using Form IL-2210.

- Taxpayers will occasionally comment that they cannot determine their required estimated payments because they cannot accurately predict their current year income. Unless they are a first-year filer, the IITA says payments can be based on 100% of the prior year return. Therefore, unless a first-year filer, the taxpayer always has a basis to calculate required ES payments.

Refer to IITA §§ 803 and 804, and 86 IAC §§ 100.8000 and 100.8010 for further explanation, as well as Form IL-1040-ES, for further guidance.

2. EXTENSION PAYMENTS (IL-505-I)

For taxpayers who will be unable to file by the original due date of the return, an extension payment can be made to pay any tentative tax liability and avoid late-payment penalty.

- Extension payments are made with the voucher Form IL-505-I, Automatic Extension Payment for Individuals Filing Form IL-1040. The extension payment is due by the original due date of the return (the 15th day of the fourth month after the close of the taxable year, generally April 15 for calendar filers unless it falls upon a weekend/holiday).

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- Penalty and interest will be assessed on any unpaid liability that remains after the extension payment is applied. Form IL-505-I can be obtained from the Department's website under Forms.

3. OVERPAYMENT FROM PREVIOUS YEAR (CREDIT CARRYFORWARDS)

Effective January 1, 2015, PA 98-0825 provides for a change to IITA § 909 as to the application of overpayments. Overpayments from one tax year can be requested on Forms IL-1040 or IL-1040-X to be applied as a credit to a future tax year. These are referred to as credit carryforwards. This election/overpayment is governed by the following:

- must be done by the extended due date of the return. This means that a taxpayer cannot file a Form IL-1040 after the extended due date and request a credit carryforward.
- credit carryforward may be reduced if math error adjustments were made to the overpayment year's return and reduced the overpayment. Likewise, that credit carryforward may be applied against any other taxpayer liabilities, leaving the balance to be applied to the following year (if not completely offset). However, audit adjustments to the overpayment year do not reduce the credit carryforward. Instead the credit carryforward is treated the same as a refund that was paid.
- overpayment will be applied to the next ES payment that is due, if the taxpayer has not specified a given year. If the credit is reduced, the Department is supposed to issue a notice explaining such adjustment, and the taxpayer can make a timely payment thereafter to avoid a potential IITA §§ 804 or 1005(a) penalty. Ref: IITA § 909(b) and 86 IAC § 100.9400(b).
- overpayment will be applied to any tax year after the year of overpayment, if the taxpayer has specified that year.
- for tax years prior to 2014, the taxpayer must provide a written explanation (attached to the tax form) as to what tax period (year) the overpayment should be applied to, since the tax forms for those years will not be updated to provide for line changes for such a credit carryforward request.

Credit Carryforward Problems

Common problems with credit carryforwards that can affect the taxpayer are the following:

- a math error that reduces the overpayment (even creating a liability)
- other liabilities offset by the overpayment.

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In either case, the requested credit carryforward is reduced, and the taxpayer is notified, but does not timely pay to restore the credit, correct the math error, or simply ignores the notice.

- The following tax year the tax payer claims the full credit carryforward that was requested and is actually underpaid. This may occur several years until the taxpayer receives a bill for a balance due, and then is confused about being underpaid.
- When penalties and interest are assessed each year, it can require examining several years of reduced credit carryforwards to determine the original discrepancy.

Example 1: Taxpayer makes four timely $100,000 estimated payments in 2011. The taxpayer timely files a 2011 Form IL-1040, requesting a 2012 credit carryforward of $50,000. The taxpayer's 2011 return was adjusted in processing due to a math error (Schedule CR credit was reduced by $30,000), which left only $20,000 available for the 2012 credit carryforward. A notice was sent to the taxpayer and no support was provided nor payment made, so $20,000 was the credit applied to 2012.

In 2012, the taxpayer made four timely $50,000 estimated payments, and claimed the original $50,000 2012 credit, for a total of $250,000 and an overpayment of $30,000 to be refunded. Again, this year's Schedule CR credit was reduced, by $20,000, and the taxpayer's actual payments should be $220,000. Therefore, the taxpayer has an actual return liability of $20,000. When auditing this period, the auditor may have to review the returns and payments in GenTax to understand what credits were claimed, what were allowed, and any adjustments.

Example 2: Taxpayer is audited for calendar years 2009 through 2011. Taxpayer presents the auditor a finalized 2009 RAR and 2009 Form IL-1040-X, creating a claim for $5,000. The auditor found no 2009 or 2011 adjustments but found a 2010 audit liability of $7,500. Taxpayer requested that the $5,000 overpayment be applied as a credit carryforward to 2010. The auditor explained that each year's total balance due or refund, including penalty and interest, will be determined and then may be offset to determine the total audit liability or refund. Once this is completed, any available overpayment can be applied as a credit carryforward.

C. PASS-THROUGH ENTITY TAX PAYMENTS

For tax years ending on or after December 31, 2008, the total of any pass-through entity tax payments (income tax paid) made on the taxpayer's behalf by a partnership, S Corporation, or trust are shown on the taxpayer's Schedule K-1-P or K-1-T. In order for

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the taxpayer (partner, shareholder, or beneficiary) to receive credit for these payments, a copy of the Schedule K-1-P or K-1-T must be attached to their Form IL-1040 when filed.

D. EARNED INCOME CREDIT (EIC)

IITA § 212(a) provides for this credit as follows:

- For each taxable year beginning on or after January 1, 2000 and ending prior to December 31, 2012, taxpayers who qualify for a federal Earned Income Credit (EIC) can claim an Illinois EIC equal to 5% of the federal EIC.
- Beginning on or after January 1, 2012 and ending prior to December 31, 2013, 7.5% of the federal EIC can be claimed.
- Beginning on or after January 1, 2013, 10% of the federal EIC can be claimed.
- Beginning on or after January 1, 2017, and before January 1, 2018, 14% of the federal EIC can be claimed.
- Beginning on or after January 1, 2018, 18% of the federal EIC can be claimed.

IITA § 212(b) provides:

- The credit is nonrefundable for tax years beginning before 1/1/03.
- For tax years beginning on or after 1/1/03, the Illinois EIC is refundable. This is the only Illinois credit currently refundable.

For a nonresident or part-year resident, the amount of the credit shall be in proportion to the amount of income attributable to this State per IITA § 212(a). This calculation is carried out on either the EIC worksheet in the Form IL-1040 instructions (tax years 2007 and earlier) or Step 3 of the Schedule ICR (tax years 2008 and forward).

The taxpayer should keep copies of their federal income tax return, federal Schedule EIC, federal EIC worksheet, or any other documentation that verifies the amount of their federal EIC and submit such documents if requested by the Department. Again, if there is doubt that this credit was federally accepted as filed, the taxpayer should provide the auditor an IRS Account Transcript to substantiate the federal EITC.

Audit Note: It is important to adjust the federal EITC when the AGI has been adjusted during audit. If the AGI is adjusted, it can result in a drastic reduction of the Illinois EIC.

1. FEDERAL JOINT FILING REQUIREMENT

One federal requirement of the federal earned income tax credit is that married individuals must file jointly to claim the credit as stated in IRC § 32(d).

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On the Form IL-1040, a married couple may have filed separately, such as if a spouse was a part-year or nonresident, or if a spouse is filing as an injured spouse.

- The auditor in this instance must first verify that they filed joint federally and qualified for the credit. Just because the taxpayer claimed the credit does not mean that the return was accepted, and in case of any doubt of the federal credit and amount, the auditor should request an IRS Account Transcript to verify what the accepted Earned Income Tax Credit (EITC) was.

- Once the allowed EITC is determined and the allowable Illinois Earned Income Credit (EIC) is confirmed, the auditor must verify that the two spouses, in total, do not claim more than what is allowable had they filed jointly.

  Example: Taxpayer A and Taxpayer B filed a 2010 federal Form 1040 as married filing jointly and claimed an accepted EITC credit of $3,000 on Line 64a. For Illinois, they filed as married filing separately, and Taxpayer A filed as an injured spouse. Taxpayer A claimed $2,000 on Schedule ICR, Line 10a, and an Illinois EIC of $100 (.05 x $2,000). Taxpayer B claimed $1,000 on Schedule ICR, Line 10a and an Illinois EIC of $50 (.05 x $1,000). Since both together did not claim more than the total Federal EITC, thus not claiming more than the total EIC credit allowable of $150 had they filed jointly, the Illinois EIC credits are allowable.

  Still, if the taxpayer did file as married filing separately on the Illinois return, this raises the red flag of:

  - Were they eligible and received a federal EITC?

  - As with the other credits, did they individually claim more than the allowable Illinois credit, or “double-dip”?

2. EARNED INCOME CREDIT (EIC) ON SCHEDULE IL-E/EIC (TAX YEAR 2018)

The EIC for tax year 2018 is calculated on Schedule IL-E/EIC, Illinois Exemption and Earned Income Credit. This Schedule can be accessed on the IDOR website under the Individual Income Tax Forms for tax year 2018.

3. EARNED INCOME CREDIT (EIC) ON SCHEDULE IL-EIC (TAX YEAR 2017)

The EIC for tax year 2017 is calculated on Schedule IL-EIC, Illinois Earned Income Credit. This Schedule can be accessed on the IDOR website under the Individual Income Tax Forms for tax year 2017.

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4. EARNED INCOME CREDIT (EIC) ON SCHEDULE ICR (TAX YEARS 2008-2016

As with the Property Tax and Education credits, the EIC for tax years 2008 through 2016 is calculated on the Schedule ICR, as shown below from the 2010 Schedule ICR.

Schedule ICR — Page 2

Step 3: Figure your refundable credit

Earned Income Credit

10 a	Write the amount of federal EIC as shown on your U.S. 1040, Line 64a; U.S. 1040A, Line 41a; or U.S. 1040EZ, Line 9a.	**10a**	.00
b	Multiply the amount on Line 10a by 5% (.05).	**10b**	.00
c	**Illinois residents:** Write 1.0. **Nonresidents and part-year residents:** Write the decimal from Schedule-NR, Line 48.	**10c**	.
d	Multiply Line 10b by the decimal on Line 10c.	**10d**	.00
11	Write the amount from Line 10d here. This is your Illinois Earned Income Credit. Write this amount on Form IL-1040, Line 27.	→ **11**	.00

The amount from the Schedule ICR is carried to the Form IL-1040; on the 2010 Form IL-1040 it is recorded on Line 27, in the "Payments and Refundable Credit" section under Step 8. For the EIC calculation, Schedule ICR must be completed and attached to the Form IL-1040.

5. EARNED INCOME CREDIT (EIC) WORKSHEET (TAX YEARS 2007 AND PRIOR)

To determine the amount of this credit, the Earned Income Credit (EIC) worksheet (in the Form IL-1040 instructions) must be completed by the taxpayer. The appropriate worksheet can be found in the instructions for each applicable year. The amount of EIC determined on the worksheet would then be transferred over to the appropriate line on the Form IL-1040.

XVI. UNDERPAYMENT OF ESTIMATED TAX PENALTY AND DONATIONS

Starting in tax year 2008, the Penalty section and Donation section were combined on the Form IL-1040 return.

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A. LATE-PAYMENT PENALTY FOR UNDERPAYMENT OF ESTIMATED TAX

A late-payment penalty for underpayment of estimated tax may be assessed when the taxpayer is required to make estimated payments and fails to do so by the estimated payment due dates. This penalty is often referred to as the "804 penalty" because it is governed by IITA § 804.

Refer to Chapter 42 Penalty & Interest for more on the late-payment penalty.

1. USE OF FORM IL-2210

Form IL-2210, Computation of Penalties for Individuals, allows the taxpayer to figure penalties that may be owed if the taxpayer did not:

- make timely estimated payments
- pay the tax owed by the original due date, or
- file a processable return by the extended due date.

Annualized Income

Some taxpayers earn their income unevenly during the year and are allowed to annualize their income per IITA § 804(c)(2) because, although the total amount in required ES payments is the same, some periods may be less than others.

- To calculate the 804 penalty on an annualized basis, the taxpayer is required to complete Form IL-2210 and attach this to the Form IL-1040.

- Step 6 on the Form IL-2210 allows the taxpayer to compute what the four annualized ES payments would be.

Example: For calendar year 2009, Taxpayer was a partner in Partnership A. Taxpayer does not receive distribution until end of calendar year, which is the only source of Taxpayer's income. Since Taxpayer earns income unevenly during the year (only in 4th ES period), Taxpayer may annualize income using Form IL-2210. For 2008, the ES tax liability was $2,000. Taxpayer may avoid an 804 penalty by paying 100% of the prior tax year's ES liability or 90% of the current tax year. In order to avoid penalty by paying 100% of the previous year's tax, Taxpayer would need to make four timely installment payments of at least $500, since the requirement is that each payment be 25% of the prior year's liability. If Taxpayer annualizes on Form IL-2210 and makes one ES payment equal to at least 90% of his tax liability by 1/15/10, any 804 penalty would be avoided.

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2. EXCEPTIONS TO ESTIMATED TAX PAYMENTS

A list of exceptions to the 804 penalty being assessed can be found in 86 IAC § 100.8010(g). Taxpayers could possibly claim one or more of these exceptions, which should be verified by the auditor.

On Form IL-1040 the taxpayer is required to check boxes that pertain to several situations where an 804 penalty is either not assessed or calculated differently. Starting in tax year 2008, these check boxes appear as follows:

Step 10: Underpayment of Estimated Tax Penalty and Donations

29 Late payment penalty for underpayment of estimated tax. **29**

a Check if at least two-thirds of your federal gross income is from farming. ☐

b Check if you or your spouse are 65 or older and permanently living in a nursing home. ☐

c Check if your income was not received evenly during the year and you annualized your income on Form IL-2210, otherwise we will figure this penalty for you. **Attach** Form IL-2210. ☐

Starting in tax year 2012, a fourth check box was added as follows:

d Check if you were not required to file an Illinois Individual Income Tax return in the previous tax year. ☐

Example 1: Taxpayer A is under audit for calendar years 2007 and 2008. Taxpayer timely filed and paid return liabilities of $50,000 for 2007 on 4/15/08 and $62,000 for 2008 on 4/15/09. Taxpayer's ES base (tax less any credits and withholding) was $40,000 for 2007 and $50,000 for 2008. Taxpayer did not make any ES payments for either year and marked returns as "farmer" for both years. Therefore, no 804 penalty was assessed by the Department during return processing.

The auditor noticed this and inspected Taxpayer's federal returns for 2007 and 2008, discovering that less than 2/3 of gross income came from farming in either year. The audit was initiated on 6/15/11. Since the penalty is "deemed assessed" when the return is filed, notice and demand for payment of the penalty must be issued within 3 years of the filing date. IITA § 902(a). Therefore, the statute for collecting the 804 penalty is closed for 2007.

However, the 2008 statute is open until 4/15/12, so the auditor should notify Audit Perfection so that a Notice and Demand is issued for the 804 penalty. It would be $10,000 ($50,000 x .1, or (($12,500 x .1) x 4)) and doubled for Amnesty. No 804 penalty, however, would be assessed on the audit liability discovered. Only the UPIA Section 3-3(b-20)(2) would apply.

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Example 2: An audit is being performed on 2007 and 2008. Taxpayer is a nonfiler, and it is determined that the tax required to be shown is $3,000 for 2007 and $3,300 for 2008. Taxpayer agrees with the audit findings. It is determined that the 804 base for 2007 is $2,700 and $2,970 for 2008. No ES payments were made, and UPIA Sections 3-3(b-20)(1) and (2) apply. Lastly, the penalties are doubled for failure to participate in the 2010 Amnesty Program. The penalties are shown below:

Year	Section 804	Late-payment Penalty
2007	$540	$90
2008	$594	$100

The Section 804 penalty was applied first, at 10% for each installment paid over 30 days late, which in both cases is the same as 10% of the total 804 base since no ES payments were made. Then the 804 penalty base is subtracted from the total audit liability base, and 15% is the audit late-payment penalty assessed on the balance ($300 in 2007 and $330 in 2008).

Example 3: Same facts as Example 2 above, only 804 exceptions apply to Taxpayer since she is at least 65 and a permanent nursing home resident. Although no Section 804 penalty would be assessed, the UPIA Section 3-3(b-20)(2) late-payment penalty will be assessed on the full audit liability. The penalty rate is 15%, which is then doubled for failure to participate in the 2010 Amnesty Program. The results are shown below:

Year	Section 804	Late-payment Penalty
2007	$0	$900
2008	$0	$990

Note that the taxpayer actually pays more in late-payment penalties if no Section 804 is assessed. This is true for both UPIA 3 and UPIA 5, because the Section 804 penalty is capped at 15% for UPIA 3 and 10% for UPIA 5, which is lower than what the audit late payment penalty rate is. Nevertheless, for nonfilers the auditor must assess the Section 804 penalty if it applies.

3. LATE ES PENALTY IN MATH ERROR ADJUSTMENT

When dealing with a non-filer audit, it is important when reducing W-2 credits in a math error adjustment that the Late ES penalty be re-evaluated. Changes to the W-2 credits can trigger Gentax to create Late ES penalties. The auditor must note in the math error letter to the taxpayer when this Late ES penalty is being assessed.

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Example of period after math error change for W-2 credits. Note the Late ES penalty.

[redacted]

If a taxpayer files an IL-1040 return in audit as the result of a non-filer inquiry and the taxpayer claims an amount of withholding credit that is subsequently reduced for lack of support, the late ES payment penalty must be evaluated. A reduction in the withholding credit can trigger a late ES payment penalty the taxpayer was not expecting. The auditor must inform the taxpayer in a free-form letter if a late ES payment penalty is being assessed in audit and explain the circumstances that gave rise to the penalty.

B. DONATIONS

Donations (voluntary contributions) may be made to one or more of the listed charitable contribution funds provided through IITA § 509. A listing of most previous and current contribution funds may be found in IITA § 507-507III. Some of these sections have been repealed since the checkoff failed to receive the minimum contributions needed to be retained on the return. The Alzheimer's Disease Research Fund checkoff provision is in 410 ILCS 410/2 and the Illinois Wildlife Protection Fund checkoff provision is in 30 ILCS 155/3.

For tax years 2008 and forward, the list of contribution was moved from Form IL-1040 onto Schedule G, Voluntary Charitable Donations. Schedule G must be completed and attached to the Form IL-1040. Following are the donations available on the 2017 Schedule G as shown below:

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Step 2: Donations

Note: Any donation will reduce your refund or increase the amount you owe.

1 Enter the amount you wish to donate to each of the following voluntary charitable donation funds. You may contribute any whole-dollar amount of $1 or more. See the instructions for a detailed description of each fund.

(Whole dollars only)

a **Wildlife Preservation Fund** a _____.00
Donations support projects to protect and manage native plants and animals in Illinois.

b **Alzheimer's Disease Research Fund** b _____.00
Donations support research for the cure and treatment of Alzheimer's Disease.

c **Assistance to the Homeless Fund** c _____.00
Donations support local not-for-profit agencies that provide shelter, meals, and services needed by homeless families and individuals.

d **Diabetes Research Fund** d _____.00
Donations support research on the detection, prevention, screening, management, and treatment of diabetes.

e **Thriving Youth Fund** e _____.00
Donations support community-based programs in Illinois that provide services promoting positive outcomes for youth.

f **Criminal Justice Information Projects Fund** f _____.00
Donations fund grants for Illinois police memorials, including academic scholarships and financial assistance.

2 Add Lines a through f. This is your total donation. Enter this amount on Line 34 of your 2017 Form IL-1040. → 2 0.00

It is important that the taxpayer realize that once the selection and donation amount is made, this amount is irrevocable and is due. It will either reduce the taxpayer's refund or increase the liability due. If a return is adjusted during processing or an audit, the taxpayer cannot amend to change the contribution amounts.

Example 1: For tax year 2010 Taxpayer A reported an overpayment before donations of $3,000 and $500 in donations, claiming a refund on Line 35 of $2,500. A math error was found during processing, which increased the Line 15 total tax so that Taxpayer A was only overpaid $200 (as opposed to the original overpayment of $3,000) before donations. Taxpayer A, therefore, has a return liability of $300 ($200-$500) and cannot file an amended return to reduce (or increase) the voluntary contributions.

Example 2: For tax year 2008 Taxpayer A reported an overpayment of $3,000 before donations and claimed $500 in donations, resulting in a refund of $2,500. This refund was issued to Taxpayer A. In 2011 an audit was performed on years 2007 and 2008. For 2008, the Schedule CR credit was reduced, resulting in an audit liability of $2,000. Taxpayer A cannot file a Form IL-1040-X to reduce Voluntary Contributions in the attempt to reduce the audit liability.

XVII. REFUND OR AMOUNT OWED

A. REFUND

Any overpayment net of penalties and donations is available for refund, credit carryforward, or a combination of the two. This amount, however, is still available for

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Department offset against any other liability with the Department, as per IITA § 909(a). After any offsets, the remaining amount is available for refund.

The Department may also withhold refunds for liabilities with other agencies. This includes liabilities with other states, the IRS, debts owed to the State of Illinois, child support, and certain fees owed to the Clerk of the Circuit Court. Ref: IITA § 911.3.

1. REFUND APPLIED TO ESTIMATED TAX FOR A LATER TAX YEAR (CREDIT CARRYFORWARD)

Previously, the taxpayer could choose to apply all or part of a refund to the next year's estimated tax liability as provided for in IITA § 909(b). IAC § 100.9400(b) also addresses credit carryforwards. Effective January 1, 2015, PA 98-0825 provides for a change to IITA § 909 as to the application of overpayments as credits, credit carryforwards (CCFs). The taxpayer can now specify that the CCF be applied to any future tax year, not just to the next year's tax liability. Requests for a CCF are now allowed on the amended return.

- The credit is to be applied depending on whether an original or amended return was filed.
  - For original returns, the CCF is applied to the following year.
  - For amended returns, unless the taxpayer specifies otherwise, the CCF should be applied to the next ES payment that is due.

- Original returns - It must be requested on a timely filed original return, and once made is irrevocable. This means that the credit must be claimed on a Form IL-1040 filed before the extended due date.

- Late-filers and nonfilers cannot request a credit. However, although the credit would not be honored, any overpayment would be refunded.

- Amended returns – a CCF can be requested.

- If a credit is reduced due to Department offset, a notice is sent to the taxpayer providing them an opportunity to pay the balance due to avoid being underpaid in the following tax year and potentially facing an 804 penalty.

In an audit situation, a nonfiler could have had timely estimated payments and claim a timely return was filed requesting a credit carryforward, but if the taxpayer cannot substantiate that a timely return was filed with the Department (i.e. copies of certified mailing receipts), the credit would not be honored, and any overpayment would be refunded. By the time an audit occurs, any net overpayment that results from an audit will be refunded and never applied as a credit to the following year, regardless of any underpayment or 804 penalty in the subsequent tax period.

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2. OFFSETS WITHIN AN AUDIT PERIOD

It is not uncommon in an audit including multiple tax years for the taxpayer to be overpaid in one year and underpaid in others. The taxpayer may request that the overpayment be used to offset the underpaid liability. Such offset requests should be made in writing by the taxpayer, authorizing the auditor to "offset" within the audit period.

B. AMOUNT OWED

A variety of payment options are available either by MyTaxIllinois, credit card, and check or money order. See the Form IL-1040 instructions for details on payment options.

1. LATE FILING OR LATE PAYMENT

If either the return is not filed, or the tax is not paid timely, penalties and interest may be owed. The Department will issue a bill. However, the taxpayer may figure the penalties by completing and submitting Form IL-2210, Computation of Penalties for Individuals (see Section XVI.A.1. above).

- More information on the penalties and interest can be seen in Chapter 42, Penalty & Interest.

2. FRIVOLOUS RETURNS

In addition to any other penalty provided for under the IITA, a $500 penalty is imposed upon any individual who files a purported return (Form IL-1040) that does not contain information to establish correct tax liability or contains substantially incorrect information which would deem the return to be "frivolous". This penalty for a frivolous return applies to returns filed for taxable years ending on or after December 31, 1987. Ref: IITA § 1006 and 86 IAC § 100.5050.

The filing of a frivolous return may apply in a "tax protester (or protestor)" situation. A "tax protester" is someone who refuses to pay a tax on constitutional or legal grounds. Many will claim the tax laws are unconstitutional or otherwise invalid, while some refuse to file a tax return or file returns with no income or tax data supplied (frivolous returns).

XVIII. SIGN AND DATE

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The taxpayer (and spouse, if filing jointly) must sign and date the return. If filing for a minor as a parent or guardian, the parent (or guardian) must sign and date the return. IITA § 503(a) states that if a signature is on the return, then it is presumed to be the authentic signature.

A return that has not been signed is considered "unprocessable", and a non-filer penalty may apply. IITA § 503(e) provides that if a taxpayer fails to sign a return within 30 days after proper notice and demand for signature by the Department, then the liability is deemed assessed and the taxpayer forfeits any overpayment if not provided within 3 years of the filing date.

This also applies to any amended return that the taxpayer would provide the auditor during the audit.

XIX. AUDIT PURPOSE, FLOW AND CONCLUSION

A. PURPOSE

The purpose of an IIT audit is to verify that the federal tax information (FTI) affecting the state return is correctly reported and to check for any mathematical or procedural errors on the Form IL-1040 and/or any attached schedules. Normally, audit assignments on Form IL-1040 filers are selected for either a particular issue or compliance checks but may also be initiated as a result of referrals made by other auditors or other divisions within the Department, such as Individual Processing Division, or as a result of a Sales Tax audit.

B. FLOW

Conceptually, the IIT audit will flow much like a BIT audit. **Refer to the audit procedure guidelines found in Chapter 20.** Although Chapter 20 is written to address BIT audits, much of the information can be utilized in an IIT audit.

NOTE: Audit Flow procedures have changed. Refer to AM Chapter 20 for the new Audit Flow process in the "Audit Submission and Review" section of that chapter.

1. INITIATION

Since most IIT audits are performed in-house, the auditor does not normally conduct a meeting with the taxpayer in person, as in a BIT audit. Most communication with the taxpayer will be via telephone, email, and/or written correspondence.

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The audit initiation letter (EDA-135) will be systemically generated from GenTax when the RAS assigns the audit to the auditor [stage – assigned started]. Letters are mailed in the overnight batch process from Springfield. If there is an issue with the taxpayer's address, the auditor will need to invalidate the audit initiation letter and manually create a new one. The new letter will batch print from Springfield.

❖ See Chapter 20, Exhibit E – How to Create the EDA-135.

2. CONDUCTING THE AUDIT

Refer to Chapter 20 for audit procedure guidelines.

NOTE: Audit Flow procedures have changed. Refer to AM Chapter 20 for the new Audit Flow process in the "Audit Submission and Review" section of that chapter.

3. AUDIT EXPANSION

If it is determined that the audit needs to be expanded to include additional years after the initiation letter has been sent, an Audit Expansion Letter (EDA-136) will need to be sent to the taxpayer. Refer to Chapter 20 for instructions on generating this letter.

4. GENTAX FEDERAL TAX INFORMATION BANNER

Since February 29, 2016, a ~~new~~ message (below) is displayed in Gentax when data is presented that contains Federal Tax Information (FTI).

The message includes a link (i.e. click here) to the IRS required procedure that must be followed if the screen is printed. Therefore, it is highly recommended that screens only be printed when absolutely necessary.

If you print a screen from GenTax that has FTI on it, you must take the following steps:

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1. Print the IDR-487-G and staple it to the front of the page containing FTI.
2. Complete the Tracking Log and email it to the Disclosure Officer at REV.DisclosureOfficer@illinois.gov immediately.
3. Security measures must be taken for this screen-print by storing it in a secure area such as a locked desk or filing cabinet, vault, locked room, etc. when not being worked. Any document, report, form, or correspondence that is FTI or contains Social Security numbers, banking information, or entity-specific tax return data should be treated as a confidential document and should be secured at all times.
4. Add an entry on the IDR-487-G any time an individual views the FTI information. Each time an individual looks at the information must be documented.
5. When you are finished with the screen print, it must be destroyed immediately (placed in a locked shred bin for destruction). You must email the Disclosure Officer the log again indicating the date the document was placed in the locked shred bin.

For additional information pertaining to Federal Tax Information, see AM Ch 1.

C. CONCLUSION

NOTE: Audit Flow procedures have changed. Refer to AM Chapter 20 for the new Audit Flow process in the "Audit Submission and Review" section of that chapter.

Effective July 1, 2019 all audits are required to be submitted electronically utilizing the *Audit File Template* folder, which will be zipped and attached as one item in Gentax for review and submission. The organization of the folders and file names are stipulated in the *IT Index*, which is included in the template folder and should be completed in lieu of the EDA-51 (the EDA-51 is no longer required). Refer to AMU IT19-05 Electronic Audit Submission – Zipped Folder, which has been incorporated into Chapter 20.

TAXPAYER PROTESTS IN UNAGREED AUDITS

The taxpayer has several avenues in which to "protest" unagreed audits once a Notice of Deficiency (NOD) or a Notice of Claim Denial (NOCD) is issued.

- See Chapter 20, Section XII – Taxpayer Protests, for complete information on these avenues available to taxpayers.

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XX. DEFAULTED NODS – RECEIPT OF ADDITIONAL TAXPAYER INFORMATION

This section provides guidance for Review and Perfection Sections when issues that arise after the default of the NOD and the receipt of additional correspondence/information/documentation/returns from a taxpayer. The main concern is when the audit has already been closed, but then the taxpayer provides additional information. When a closed audit is re-opened, all the financial transactions associated with that audit **are lost**, so re-opening that audit creates problems. The following provides different scenarios and the treatment without re-opening the audit:

1) The taxpayer provides proof of previous payment or withholding. The tax amount is not changed, but the balance due is affected. A signature may or may not be received, but the account is adjusted, and the balance is modified to reflect the withholding or verified payment.

   Do not re-open the previous audit, but just adjust the account and issue a revised statement of account.

2) The taxpayer provides information (not a return) supporting either a deduction or credit. The tax may or may not change, but deductions and credits are privileges, not rights. Taxpayer signature is required.

In order to be allowed a deduction or credit, the taxpayer must timely file a return to claim such credits and deductions. The exception is withholding, as the Department allows a credit for withholding even where the taxpayer fails to file a timely return. If the Department has issued a notice disallowing a credit/deduction taken on a return, and the taxpayer later provides sufficient documentation, the original notice can be revised without audit re-opening.

3) The taxpayer files an original return. Taxpayer signature is required and is usually present because it is a return.

<u>Processable</u>: If the return is processable, adjust the account, cancel any prior notices, and re-issue any appropriate notice based on the filing.

<u>Not processable</u>: If the return is not processable, a letter of explanation should be sent to the taxpayer.

Note: If the return is **not** timely, the taxpayer is not entitled to claim any deductions or credits, except for withholding and prior payments. This should be a new work item, not something that re-opens the prior audit.

4) <u>Adjustments that seem against statute [IITA 903(a)(2) and 904(d)]:</u>

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The taxpayer has not paid, or there is no signature, or they did not timely protest the NOD. The Department (Audit) is well within OUR rights to actually request the proper method of correction be followed.

Our records can always be adjusted to reflect information provided by the taxpayer. If the audit is closed and sent to stores, the taxpayer should be advised to **file an amended return** with all appropriate attachments in order to adjust the account accordingly.

Note: No refunds can be issued unless the amended return is filed within the appropriate statute of limitations.

5) Collection activity present:
NOD has defaulted. The taxpayer files an amended return to reduce the liability – no payments made or reflected on the filing. Collections takes levy action and seizes funds for liability prior to processing of the audit. The question is whether the taxpayer has to fix the amended to reflect the money (payments), or can the Department just adjust accordingly.

The Department can correct the amended return to reflect the proper payments and issue the appropriate refund (if within statute). The taxpayer does not need to submit another return to reflect amounts obtained through the levy.

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XX. EXHIBITS

A. EXHIBIT A – SCHEDULE NR – PART-YEAR RESIDENT EXAMPLE

In 2009, John Taxpayer was an Illinois resident, until he quit his job at the end of August and moved out of state permanently (to Hawaii). Starting in October of that same year, John went to work at his brother's surf board shop as a salesman. For the 2009 tax year, the following information will be used by John to complete his Form IL-1040 and Schedule NR as a part-year resident:

- Federal Form 1040, line 7 (wages, salaries, tips, etc.) - $80,000 – John's Illinois wages were $74,000, while his Hawaii wages were $6,000.
- Federal Form 1040, line 8a (taxable interest income) - $2,000 – all of this interest income was earned through Certificates of Deposit (CDs) that John had while living in Illinois.
- Federal Form 1040, line 21 (other income) - $50,000- money that John had won playing the Illinois State Lottery while an Illinois resident.
- John is 48 years old, single, and has no dependents, so he qualifies for only one exemption on the federal Form 1040.

To determine John's Illinois base income and the tax before recapture of investment credits for Form IL-1040, Schedule NR must be completed. John's 2009 Schedule NR figures appear as follows, which show that John's Illinois Base Income from Schedule NR is $126,000.00 and the tax before recapture of investment credits is $3,723.00. Both of these figures will be used by John to complete his Form IL-1040.

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Step 3: Figure the Illinois portion of your federal adjusted gross income

	Column A Federal Total	Column B Illinois Portion
5 Wages, salaries, tips, etc. (federal Form 1040 or 1040A, Line 7; 1040EZ, Line 1)	80,000.00	74,000.00
6 Taxable interest income (federal Form 1040 or 1040A, Line 8a; 1040EZ, Line 2)	2,000.00	2,000.00
19 Other income (federal Form 1040, Line 21) Include winnings from the **Illinois State Lottery** as Illinois income in Column B.	50,000.00	50,000.00
20 Add Column B, Lines 5 through 19. This is the Illinois portion of your federal total income.		126,000.00
21 Write the Illinois portion of your federal total income from Page 1, Step 3, Line 20.		126,000.00
36 Add Column B, Lines 22 through 35. This is the Illinois portion of your federal adjustments to income.		0.00
37 Write your adjusted gross income as reported on your federal Form 1040, Line 37; 1040A, Line 21; 1040EZ, Line 4.	132,000.00	
38 Subtract Line 36 from Line 21. This is the Illinois portion of your federal adjusted gross income.		126,000.00

Step 4: Figure your Illinois additions and subtractions

41 Add Column B, Lines 38, 39, and 40. This is the Illinois portion of your total income.		126,000.00
45 Add Column B, Lines 42 through 44. This is the total of your Illinois subtractions.		0.00

Step 5: Figure your Illinois income and tax

46 Subtract Line 45 from Line 41. If Line 45 is larger than Line 41, write zero. This is your **Illinois base income**. Write this amount on your Form IL-1040, Line 12.		126,000.00
47 Write the base income from Form IL-1040, Line 9.	132,000.00	
48 Divide Line 46 by Line 47 (carry to three decimal places). Write the appropriate decimal. If Line 46 is greater than Line 47, write 1.000.	.955	
49 Write your exemption allowance from your Form IL-1040, Line 10.	2,000.00	
50 Multiply Line 49 by the decimal on Line 48. This is your Illinois exemption allowance		1,910.00
51 Subtract Line 50 from Line 46. This is your Illinois net income.		124,090.00
52 Multiply the amount on Line 51 by 3% (.03). This amount may not be less than zero. This is your tax before recapture of investment credits. Write this amount on your Form IL-1040, Line 13.		3,723.00

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B. EXHIBIT B – SCHEDULE NR – NONRESIDENT EXAMPLE

Sue Smith is a resident of Gary, Indiana, but works in Chicago for an architectural firm during the week. On Saturday nights, Sue works as a bartender at a local bar & grill in Gary. For the 2009 tax year, the following information will be used by Sue to complete her Form IL-1040 and Schedule NR as a nonresident:

- Federal Form 1040, line 7 (wages, salaries, tips, etc.) - $50,000 –Sue's wages earned in Illinois were $45,000, while $5,000 was wages/tips earned by bartending.

- Federal Form 1040, line 8a (taxable interest income) - $500 – all of this interest income was earned through a savings account that Sue has at her bank in Indiana.

- Sue is 34 years old, single, and has no dependents, so she qualifies for only one exemption on the federal Form 1040.

To determine Sue's Illinois base income and the tax before recapture of investment credits for Form IL-1040, Schedule NR must be completed. Sue's 2009 Schedule NR figures appear as follows, which shows that Sue's Illinois Base Income from Schedule NR is $45,000.00 and the tax before recapture of investment credits is $1,297.00. Both of these figures will be used by Sue to complete her Form IL-1040.

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Step 3: Figure the Illinois portion of your federal adjusted gross income

	Column A Federal Total	Column B Illinois Portion
5 Wages, salaries, tips, etc. (federal Form 1040 or 1040A, Line 7; 1040EZ, Line 1)	50,000.00	45,000.00
6 Taxable interest income (federal Form 1040 or 1040A, Line 8a; 1040EZ, Line 2)	500.00	0.00
20 Add Column B, Lines 5 through 19. This is the Illinois portion of your federal total income.		45,000.00
21 Write the Illinois portion of your federal total income from Page 1, Step 3, Line 20.		45,000.00
36 Add Column B, Lines 22 through 35. This is the Illinois portion of your federal adjustments to income.		0.00
37 Write your adjusted gross income as reported on your federal Form 1040, Line 37; 1040A, Line 21; 1040EZ, Line 4.	50,500.00	
38 Subtract Line 36 from Line 21. This is the Illinois portion of your federal adjusted gross income.		45,000.00

Step 4: Figure your Illinois additions and subtractions

41 Add Column B, Lines 38, 39, and 40. This is the Illinois portion of your total income.		45,000.00
45 Add Column B, Lines 42 through 44. This is the total of your Illinois subtractions.		0.00

Step 5: Figure your Illinois income and tax

46 Subtract Line 45 from Line 41. If Line 45 is larger than Line 41, write zero. This is your **Illinois base income**. Write this amount on your Form IL-1040, Line 12.		45,000.00
47 Write the base income from Form IL-1040, Line 9.	50,500.00	
48 Divide Line 46 by Line 47 (carry to three decimal places). Write the appropriate decimal. If Line 46 is greater than Line 47, write 1.000.	.891	
49 Write your exemption allowance from your Form IL-1040, Line 10.	2,000.00	
50 Multiply Line 49 by the decimal on Line 48. This is your Illinois exemption allowance.		1,782.00
51 Subtract Line 50 from Line 46. This is your Illinois net income.		43,218.00
52 Multiply the amount on Line 51 by 3% (.03). This amount may not be less than zero. This is your tax before recapture of investment credits. Write this amount on your Form IL-1040, Line 13.		1,297.00

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C. EXHIBIT C – HOW TO COMPLETE SCHEDULE CR – 2010 EXAMPLE

During tax year 2010, the taxpayer was a full-year Illinois resident. However, he had rental income ($7,000) earned outside of Illinois which was taxed by the other state. Schedule CR, Column A, Step 2 will equal his federal return, while Column A, Step 3 is his Illinois 1040 through Line 9. The taxpayer's completed 2010 Schedule CR, Steps 2 through 6, is shown below:

Step 2: Figure the Illinois and non-Illinois portions of your federal adjusted gross income

Write the amounts in Column A exactly as reported on
- your federal return if you were an Illinois resident, or
- the equivalent line of your Schedule NR, Column B if you were a part-year resident.

Read the instructions before completing this step.

			Column A Total (Whole dollars only)	Column B Non-Illinois Portion (Whole dollars only)
Income	1 Wages, salaries, tips, etc. (federal Form 1040 or 1040A, Line 7; 1040EZ, Line 1)	1	75,000 .00	.00
	2 Taxable interest income (federal Form 1040 or 1040A, Line 8a; 1040EZ, Line 2)	2	1,000 .00	.00
	3 Ordinary dividend income (federal Form 1040 or 1040A, Line 9a)	3	.00	.00
	4 Taxable refunds, credits, or offsets of state and local income tax (federal Form 1040, Line 10)	4	.00	
	5 Alimony received (federal Form 1040, Line 11)	5	.00	
	6 Business income or loss (federal Form 1040, Line 12)	6	.00	.00
	7 Capital gain or loss (federal Form 1040, Line 13 or 1040A, Line 10)	7	.00	.00
	8 Other gains or losses (federal Form 1040, Line 14)	8	.00	.00
	9 Taxable IRA distributions (federal Form 1040, Line 15b; or 1040A, Line 11b)	9	.00	
	10 Taxable pensions and annuities (federal Form 1040, Line 16b; or 1040A, Line 12b)	10	.00	
	11 Rents, royalties, partnerships, S corporations, trusts, and estates (federal Form 1040, Line 17)	11	4,000 .00	7,000 .00
	12 Farm income or loss (federal Form 1040, Line 18)	12	.00	.00
	13 Unemployment compensation and Alaska Permanent Fund dividends (federal Form 1040, Line 19; 1040A, Line 13; 1040EZ, Line 3)	13	.00	
	14 Taxable Social Security benefits (federal Form 1040, Line 20b; or 1040A, Line 14b)	14	.00	
	15 Other income (federal Form 1040, Line 21)	15	.00	.00
	16 Add Columns A and B, Lines 1 through 15.	16	80,000 .00	7,000 .00

			Column A Total (Whole dollars only)	Column B Non-Illinois Portion (Whole dollars only)
	17 Write the amounts from Page 1, Line 16.	17	80,000 .00	7,000 .00
Adjustments to Income	18 Deduction for Educator Expenses (federal Form 1040, Line 23; or 1040A, Line 16)	18	.00	.00
	19 Certain business expenses of reservists, performing artists, and fee-based government officials (federal Form 1040, Line 24)	19	.00	.00
	20 Deduction for health savings account (federal Form 1040, Line 25)	20	.00	.00
	21 Moving expenses (federal Form 1040, Line 26)	21	.00	.00
	22 Deduction for one-half of self-employment tax (federal Form 1040, Line 27)	22	.00	.00
	23 Self-employed (SEP), SIMPLE, and qualified plans (federal Form 1040, Line 28)	23	.00	.00
	24 Self-employed health insurance deduction (federal Form 1040, Line 29)	24	.00	.00
	25 Penalty on early withdrawal of savings (federal Form 1040, Line 30)	25	.00	.00
	26 Alimony paid (federal Form 1040, Line 31a)	26	.00	.00
	27 Total IRA deduction (federal Form 1040, Line 32; or 1040A, Line 17)	27	.00	.00
	28 Deduction for student loan interest (federal Form 1040, Line 33; or 1040A, Line 18)	28	.00	.00
	29 Deduction for tuition and fees (federal Form 1040, Line 34; or 1040A, Line 19)	29	.00	.00
	30 Domestic production activities deduction (federal Form 1040, Line 35)	30	.00	.00
	31 Other adjustments (see instructions)	31	.00	.00
	32 Add Columns A and B, Lines 18 through 31.	32	0 .00	0 .00
	33 Subtract Columns A and B, Line 32 from Line 17.	33	80,000 .00	7,000 .00

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Step 3: Figure your Illinois additions and subtractions

In Column A, write the total amounts from your Form IL-1040. You must read the instructions for Column B to properly complete this step.

Illinois Adjustments		Column A Form IL-1040 Total (Whole dollars only)	Column B Non-Illinois Portion (Whole dollars only)
34	Federally tax-exempt interest income (Form IL-1040, Line 2)	34 500 .00	.00
35	Other additions (Form IL-1040, Line 3)	35 .00	.00
36	Add Columns A and B, Lines 33, 34, and 35.	36 80,500 .00	7,000 .00
37	Federally taxed Social Security and retirement income (Form IL-1040, Line 5)	37 .00	
38	Illinois Income Tax overpayment included on your U.S. 1040, Line 10. (Form IL-1040, Line 6)	38 .00	
39	Other subtractions (Form IL-1040, Line 7)	39 200 .00	.00
40	Add Columns A and B, Lines 37 through 39.	40 200 .00	0 .00
41	Subtract Columns A and B, Line 40 from Line 36. If Line 40 is larger than Line 36, write zero.	41 80,300 .00	7,000 .00

Step 4: Figure your Schedule CR decimal

Decimal		Column A	Column B
42	Write the amount from Line 41, Column A and Column B.	42 80,300 .00	7,000 .00
43	Divide Column B, Line 42 by Column A, Line 42 (carry to three decimal places). Write the appropriate decimal. If Column B, Line 42 is greater than Column A, Line 42, write 1.000. Write this amount on Step 6, Line 53. →	43 .087	

Step 5: Part-year residents only (Full year residents, go to Step 6.)

Part-Year Only		
44	Write the base income from your IL-1040, Line 9.	44 .00
45	Divide Column A, Line 42 by Line 44 (carry to 3 decimal places).	45 .
46	Write the exemption amount from Form IL-1040, Line 10.	46 .00
47	Multiply Line 45 by Line 46.	47 .00
48	Subtract Line 47 from Column A, Line 42.	48 .00
49	Multiply Line 48 by 3% (.03). Write this amount on Step 6, Line 52, and continue on to Step 6, Line 50.	49 .00

Step 6: Figure your credit

Credit for Tax Paid to Other States		
50	If you are claiming a credit for tax paid to any of the states listed below, check the box for the appropriate state. ☐ Iowa ☐ Kentucky ☐ Michigan ☐ Wisconsin	
51	Write the total amount of income tax paid to other states on Illinois base income (see instructions).	51 280 .00
52	**Illinois Residents:** Write your Illinois tax due from Form IL-1040, Line 13. **Part-year Residents:** Write the amount from Step 5, Line 49.	52 2,349 .00
53	Write the decimal amount from Step 4, Line 43 here.	53 .087
54	Multiply Line 52 by Line 53.	54 204 .00
55	Compare the amounts on Lines 51 and 54. Write the lesser amount here and on Form IL-1040, Line 17. This is your tax credit.	55 204 .00 ←

On the taxpayer's 2010 Form IL-1040, the tax credit amount (for income tax paid to another state) of $204 would be entered on Line 17.

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D. EXHIBIT D – HOW TO COMPLETE SCHEDULE CR – 2006 EXAMPLE

Using the same taxpayer facts from Exhibit C above, the 2006 Schedule CR can be completed. Assume that the state in question was Indiana, and the taxpayer correctly calculated the Column B double-taxed income and Column C tax amount correctly per the Publication 111 formulas for Indiana as shown.

Comparison Formulas for Schedule CR
Information is based on 2006 forms and Regulation Section 100.2197

State	Necessary Attachments to CR Schedule	Income Equivalent to Enter in Schedule CR, Column B	Tax Equivalent to Enter in Schedule CR, Column C	Comments
Indiana	IT-40PNR Schedule A Schedule D	IT-40PNR, Line 3 **Plus** Schedule D, Lines 1, 2, 9, and any human services deduction (#605), Indiana partnership long-term care policy premiums deduction (#608), and medical savings contributions (#612) on Line 11 **Minus** Schedule A, Line 24B **Minus** any valuation limitation or ridesharing income on IL-1040, Line 9, and included in IT-40PNR, Line 3.	IT-40NPR Line 17 **Minus** Lines 14, 15, 16, 21, 22, 23, 24, and 25	

Lastly, assume the taxpayer had one exemption, the Illinois tax was $2,349.00, and the Indiana tax paid and allowable per Publication 111 is $280.00. Shown below is the Schedule CR:

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Step 2: Figure your credit

1 **Residents:** Write your Illinois base income from Form IL-1040, Line 11.
Part-year residents: Write only the amount from Step 5, Line 50 of Schedule NR, that you earned while an Illinois resident. 1 80,300.00

2 See instructions before completing Columns A, B, and C.

	Column A: State (Two letter state abbreviation)	Column A: Name of other taxing district (i.e., county, city or local - see instructions)	Column B: Illinois base income taxed by other state (may not exceed Line 1 - see instructions)	Column C: Income tax paid to other state (on the income shown in Column B - see instructions for proration example)
a	IN		7,000.00	280.00
b				
c				
d				
e				
f				
g				
h				

3 Add Column C, Lines 2a through 2h (and the amounts from Column C of any additional pages you attached). This is the total income tax paid to other states on Illinois base income. 3 280.00

4 Write your double-taxed base income from Column B (and the amounts from Column B of any additional pages you attached). This amount **may not** exceed Line 1. (See instructions.) 4 7,000.00

5 Write your Illinois tax due from Form IL-1040, Line 15, or from Schedule 4255 Worksheet, Line 4, which is found in Form IL-1040 Instructions, Step 6. 5 2,349.00

6 Divide Line 4 by Line 1. (Carry to five decimal places.) This figure may not be greater than 1.00000. 6 0.08717

7 Multiply Line 5 by Line 6. 7 204.76000

8 Compare the amounts on Lines 3, 5, and 7. Write the lesser amount here and on Form IL-1040, Step 7, Line 19. This is your tax credit. 8 205.00

Attach this schedule and copies of your out-of-state tax returns to your Form IL-1040.

The tax credit allowable would be $205 (rounded), which is the lesser of Lines 3, 5, and 7, which are tax paid to other states on Illinois base income, the Illinois tax due, and the Illinois tax due times the quotient of double-taxed base income divided by Illinois base income. As indicated at the bottom of the Schedule CR, the taxpayer must include copies of all out-of-state tax returns being claimed.

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E. EXHIBIT E - SCHEDULE 1299-C, STEP 5 (2013 TAX YEAR)

Step 5: Figure your credit available to be carried forward (Keep a copy of this page in your files. You will need it to complete next year's Schedule 1299-C.)

To figure each credit amount, STOP at the first applicable line for each credit.

All line references in this Step refer to Step 4 of this schedule.

1 *Two-year credit carryforward* that is available for **one** more tax year
- If Line 9 is positive or zero, write zero here. You do not have any credit from this year to carry.
- If Line 7 is negative, write the amount from Line 8 here.
- If Line 9 is negative, write the amount as a positive number here. 1 _____

2 *Five-year credit carryforward* that is available for **one** more tax year
- If Line 11 is positive or zero, write zero here. You do not have any credit from this year to carry.
- If Line 9 is negative, write the amount from Line 10 here.
- If Line 11 is negative, write the amount as a positive number here. 2 _____

3 *Two-year credit carryforward* that is available for the next **two** tax years
- If Line 13 is positive or zero, write zero here. You do not have any credit from this year to carry.
- If Line 11 is negative, write the amount from Line 12 here.
- If Line 13 is negative, write the amount as a positive number here. 3 _____

4 *Five-year credit carryforward* that is available for the next **two** tax years
- If Line 15 is positive or zero, write zero here. You do not have any credit from this year to carry.
- If Line 13 is negative, write the amount from Line 14 here.
- If Line 15 is negative, write the amount as a positive number here. 4 _____

5 *Five-year credit carryforward* that is available for the next **three** tax years
- If Line 17 is positive or zero, write zero here. You do not have any credit from this year to carry.
- If Line 15 is negative, write the amount from Line 16 here.
- If Line 17 is negative, write the amount as a positive number here. 5 _____

6 *Five-year credit carryforward* that is available for the next **four** tax years
- If Line 19 is positive or zero, write zero here. You do not have any credit from this year to carry.
- If Line 17 is negative, write the amount from Line 18 here.
- If Line 19 is negative, write the amount as a positive number here. 6 _____

7 *Five-year credit carryforward* that is available for the next **five** tax years
- If Line 21 is positive or zero, write zero here. You do not have any credit from this year to carry.
- If Line 19 is negative, write the amount from Line 20 here.
- If Line 21 is negative, write the amount as a positive number here. 7 _____

8 *Ten-year credit carryforward* that is available for the next **eight** tax years
- If Line 23 is positive or zero, write zero here. You do not have any credit from this year to carry.
- If Line 21 is negative, write the amount from Line 22 here.
- If Line 23 is negative, write the amount as a positive number here. 8 _____

9 *Ten-year credit carryforward* that is available for the next **nine** tax years
- If Line 25 is positive or zero, write zero here. You do not have any credit from this year to carry.
- If Line 23 is negative, write the amount from Line 24 here.
- If Line 25 is negative, write the amount as a positive number here. 9 _____

10 *Ten-year credit carryforward* that is available for the next **ten** tax years
- If Line 27 is positive or zero, write zero here. You do not have any credit from this year to carry.
- If Line 25 is negative, write the amount from Line 26 here.
- If Line 27 is negative, write the amount as a positive number here. 10 _____

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F. EXHIBIT F - SCHEDULE 1299-C IN GENTAX – 2013 TAX YEAR

The following Schedule 1299-C is for a 2013 tax year return (GenTax Version 9) where the taxpayer claimed Enterprise Zone Investment Credit.

[redacted]

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LEGACY DATA REPORT
Issued August, 2016

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I. PURPOSE

When researching an account, the auditor should first check Gen Tax to see if the account information is there. This should be done as all current information for an account will be in Gen Tax. If the return or account information needed is not in Gen Tax, the auditor will then check Legacy PDF Display for this account information. Legacy PDF Display is also a useful tool to get more detailed information on converted data.

Note: IRIS has been replaced by Legacy Data Report and is no longer accessible for research purposes.

II. LOGIN PROCEDURES

Field Auditors/In House Auditors

1. Double-Click on 'shortcuts' ( ) on your desktop
2. Double-Click on 'Common' folder ( )
3. Double-Click 'Legacy PDF Display' ( )

Note: First time logging in: your name, password and entrust is required. Also, a message will appear stating the database needs cataloged, when prompted exit. You can then re-enter the application without the need to provide above information.

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III. SEARCH

[redacted]

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Note: Code Reference Sheets (If the link doesn't work – open internet browser and paste URL in address bar or type the form name in the search box on the home page)
Business Income Tax – EDA-78

Individual Income Tax – ITR-406

Withholding Income Tax – CSB-153

f

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IV. SAVE/PRINT

[redacted]

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[redacted]

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TERMS AND DEFINITIONS

Revised 08/2019

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I. PURPOSE

The purpose of this chapter is to provide a quick reference to the terminology that may be encountered when performing income tax audits.

II. RERERENCE SOURCES

A. ILLINOIS INCOME TAX ACT

- IITA § 1501

B. ILLINOIS REGULATIONS

- Title 86 IAC Part 100
- Title 86 IAC Part 100 § 100.2060 – Compassionate Use of Medical Cannabis Pilot Program Act Surcharge

C. FEDERAL STATUTORY AND ADMINISTRATIVE TAX LAW

- Internal Revenue Code (IRC)
- Treasury Regulations – Title 26 of the Code of Federal Regulations (CFR)
- 410 ILCS 130/Act

D. PUBLICATIONS

- Black's Law Dictionary - All references to BLACK'S are referring to Black's Law Dictionary, 5th Edition.

III. GENERAL INFORMATION

In order to properly perform an audit, or evaluate an account for audit, it is necessary to become familiar with the terminology used in income tax audits. In some cases, certain descriptive terms may have special or various meanings. The meaning of the terms must be clear and generally understood in order to communicate properly. Many of the terms are defined in great detail in other sections of this manual; in those instances, only a cross-reference is provided here.

This chapter should never be cited as authority for any of the definitions it contains. Except where a statute or regulation is expressly cited as the source of a definition, the definitions in this chapter are not legal definitions that can be used as a basis for applying the law to a taxpayer's situation. For example, the definition of "Manufacturer" in HH cannot be used to determine whether or not a taxpayer qualifies for the replacement tax credit, which is allowed only to retailers, manufacturers and

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miners of coal or fluorite. Where a statute or regulation or some other legal authority is cited as the source of a definition that authority should be referred to as the basis for the definition, not this chapter.

Note: Auditors should be aware that in the context of hearings (whether administrative or otherwise), only definitions found in the Illinois Income Tax Act (IITA), Illinois Regulations, Treasury Regulations, or Internal Revenue Code (IRC) should be referenced.

IV. TERMS AND DEFINITIONS

For terms not defined in this chapter, refer to the IITA or IRC.

A. ACCRUAL OF DISCOUNT

Accrual of discount on a bond means to include the difference between the price of a bond bought at an original discount and the par value of the bond in income ratably over the life of the bond, and to make corresponding adjustments to basis in the bond.

B. ADJUDICATE

To hear and settle by judicial procedure, a judicial determination of a fact, and the entry of a judgment.

C. AFFILIATED COMPANY

In general, two companies are affiliated when one owns a majority of the voting stock of the other, or when both are majority-owned subsidiaries of a single shareholder.

D. AFFILIATED GROUP

Per the federal consolidated return regulations, an affiliated group consists of one or more chains of includable corporations connected through stock ownership with a common parent that is an includable corporation, provided that the following two requirements are met:

1) The common parent must directly own stock possessing at least 80% of the total voting power of at least one of the other includable corporations and having a value equal to at least 80% of the total value of the voting stock of the corporation, and

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2) Stock meeting the 80% test in each includable corporation other than the common parent must be owned directly by one or more of the other includable corporations.

E. ALLOCATION

The common term for sourcing non-business income to a particular state or states, as compared to apportionment of business income. For income tax purposes, partnership income and non-business income can be allocated or apportioned.

F. AMORTIZED BOND PREMIUM

A bond premium is the amount paid for bonds that is in excess of the face value of the bonds.

- On tax exempt bonds this premium must be amortized
- On taxable bonds an election can be made to amortize the premium

The holder of a bond is allowed to amortize over the life of a bond the amount of bond premium they paid, using the amortization to reduce the amount of taxable interest income from the bond each year and to reduce the taxpayer's basis in the bond. Basis will be reduced to face value, if the bond is held to maturity.

An exception to this is a dealer in bonds or anyone who holds them mainly for sale to customers in the course of a trade or business is not allowed to claim a federal deduction for amortized bond premium. Instead the premium is part of the cost of the bonds.

If disallowed as a federal deduction by the applicable section of the Internal Revenue Code, the following items will be a subtraction modification for Illinois filing purposes:

- Amortized bond premium – IRC § 171(a)(2)
- Expenses incurred from federally tax exempt income – IRC § 265(a)(1)
- Interest expense – IRC § 265(a)(2) and IRC § 291(a)(3)

G. ANGEL INVESTMENT

A purchase of an equity interest, or any other expenditure, that is made by a person (or network of persons) who reviews new businesses or proposed new businesses for potential investment of their own monies. Generally, the investing entities are a trust, business, Limited Liability Corporation or an investment fund.

H. ANNUAL STATEMENT

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Insurance companies are regulated by state insurance commissions and are required to file, annually, detailed financial statements (Annual Statements) with those regulatory bodies. Annual Statements are verified and audited by Insurance Commission examiners. The National Association of Insurance Commissioners has prescribed a standardized financial report called the Annual Statement or Convention Form.

An Annual Statement will contain the following information:

1) Balance Sheet.
2) Summary of Operations.
3) Analysis of Operations.
4) Analysis of increases in reserves.
5) Exhibits supporting items on the balance sheet and the summary of operations.
6) General questions.
7) Various supporting schedules detailing items on the balance sheet and the summary of operations.
8) Schedule T which is used to make state apportionment of the premiums.

I. CALENDAR YEAR

January 1 through December 31 of any given year.

J. COMPUTER INDUSTRY DEFINITIONS

1. APPLICATION PROGRAM (APP)

A computer program that is applied to tasks outside of the computer. For example, a word processing program or spreadsheet program is an application program.

2. ACCESS TIME

The access time is the time interval between the instant that the CPU requests a transfer of data to or from a storage device and the instant such an operation is completed.

3. ARITHMETIC-LOGIC UNIT (ALU)

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The part of a computer processor (CPU) that carries out arithmetic and logic operations on the operands in computer instruction words.

4. AUTOMATIC DATA PROCESSING (ADP)

Data processing performed by electronic or electrical machines with a minimum of human assistance or intervention. The term is applied to both electro-mechanical punched card data processing and electronic data processing.

5. BIOMETRIC

Automated methods of recognizing a person based on a physiological or behavioral characteristic. Among the features measured are face, fingerprints, hand geometry, handwriting, iris, retinal, vein and voice. Biometric technologies are becoming the foundation of an extensive array of highly secure identification and personal verification solutions. Biometric-based authentication applications include workstation, network, and domain access, single sign-on, application logon, data protection, remote access to resources, transaction security and Web security.

6. CENTRAL PROCESSING UNIT (CPU)

The unit of the computer system that includes the circuits which control the interpretation and execution of instructions. In many computer systems, the CPU includes the arithmetic-logic unit, the control unit and the primary storage unit. The CPU is also known as "the central processor" or the "main frame."

7. CLOUD COMPUTING

The practice of using a network of remote servers hosted on the Internet to store, manage and process data, rather than a local server or a personal computer. Cloud computing structure allows access to information as long as an electronic device has access to the web, which allows for work remotely since a user does not have to be in a specific place to have access.

8. CONTROL UNIT

A control unit is a sub-unit of the CPU, which controls and directs the operations of the entire computer system. The control unit retrieves computer instructions in proper sequence, interprets each instruction, and thus directs

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the other parts of the computer system in the implementation of a computer program.

9. DISK DRIVE

A disk drive is a device, which can transfer data to and from a disk and send that data to and from a computer to which it is connected.

10. DISK OPERATING SYSTEM (DOS)

A program which controls communication and transfer of data between a computer and its disk drive.

11. EMULATION

To imitate one system with another so that the imitating system accepts the same data, executes the same programs, and achieves the same results as the imitated system.

12. E-COMMERCE

Buying and selling of goods and services on the Internet, especially the World Wide Web.

13. ETHERNET

A computer network architecture consisting of various specified local-area network protocols, devices, and connection methods. The system used to connect computers to a network or the internet with a physical cable, including most broadband internet connections.

14. FIREWALL

A set of related programs, located at a network gateway server that protects the resources of a private network from users from other networks. A computer firewall (most often a program run on the PC) limits the data that can pass through it and protects a networked server or client machine from damage by unauthorized users, such as hackers or spammers.

15. FLASH OR THUMB DRIVE

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A removable data storage device, usually about thumb sized which can be plugged into a PC's USB port. Seen by the PC as an extra drive, this allows the user to store and carry large amounts of data in a convenient portable size.

16. HARDWARE

Hardware is the physical computer equipment. It encompasses all of the electrical or mechanical devices including the circuit boards, monitors, and disk drives.

17. INTERFACE

An interface is a shared boundary, such as the boundary between two systems. For example, the boundary between a computer and its peripheral devices is an interface.

18. MANAGEMENT INFORMATION SYSTEM (MIS)

An information system that provides the information required to support management decision making.

19. MICROPROGRAMMING

Microprogramming is the use of special software (microprograms) to perform the functions of special hardware (electronic control circuitry). Microprograms stored in a read-only storage module of the control unit interpret the machine-language instructions of a computer program and decode them into elementary micro-instructions, which are then executed.

20. MODEM (MODULATOR-DE-MODULATOR)

A modem allows computers to communicate over a phone line. It is a device, which converts the digital signals from input/output devices into appropriate frequencies at a transmission terminal and converts them back into digital signals at a receiving terminal. There is a modem at each end of a communication channel (i.e. telephone lines) converting electrical signals from pulse to wave form and vice versa. A modem may also be called a data set, or a line adapter.

An acoustic coupler can also perform this function. The coupler allows an input/output device to be connected to a standard office telephone without the need for special wiring.

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21. MULTI FUNCTION DEVICE (MFD)

A combined printer, scanner, photocopier and fax machine.

22. OPEN SOURCE

Software in which the program's source code is freely available to the public. Unlike commercial software, open source programs can be modified and distributed to anyone. Typically, the software is free to download and use.

23. OPERATING SYSTEM

Every computer has an operating system, which can be viewed as a "master program" that runs automatically when the computer is switched on and continues to run until the computer is turned off. This system is responsible for the many routine tasks such as: providing icons and menus, controlling the various disk drives and screens, and moving the pointer whenever the mouse is moved. The most widely used PC operating system is Microsoft Windows.

24. OPERATIONAL INFORMATION SYSTEM (OIS)

An information system that collects, processes and stores data generated by the operational systems of an organization and produces data and information for input into a management information system or for the control of an operational system.

25. OPTICAL SCANNER

An optical scanner is a device that optically scans printed or written data and generates their digital representations.

26. PERIPHERAL EQUIPMENT

Peripheral equipment is any unit of equipment, except the CPU and its working storage and control units that may provide the system with outside communication. All of the input/output units and auxiliary storage units of a computer system are considered peripheral equipment.

27. PROGRAM

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A program is a list of instructions for a computer to follow to achieve a particular response. It is written in a programming language, which can be stored in the computer's memory.

Software can be stored on many different mediums. Currently, magnetic tape and disks are the most common. Magnetic tape and disks are only considered software when programs are contained on the medium.

In addition to hardware and software, the following terms are commonly used by the computer industry.

28. RAM/ROM

Random-access memory (RAM) is the read/write memory that provides temporary storage of data while the computer is operating. The contents of RAM are lost if the power supply is shut off.

Read-only memory (ROM) is the control memory for instructions and fixed (unchanging or permanent) data. Its contents cannot be altered during the operation of the computer. The retention of its contents is not dependent upon a constant supply of power.

29. ROUTER

A device used to connect networks together, for example so that several PCs can share one internet connection.

30. SEGMENTATION

The division of a program into parts so that each part can be stored within a computer's working storage and contains the necessary linkages to other parts. Each part thus formed is called a segment. Segmentation makes it possible to execute programs, which exceed the capacity of a computer's working storage.

31. SOFTWARE

The term software includes any type of program, instructions or data, which tells the hardware what to do. The software is the computer program, which make possible the use of the computer by a user. Typical software items on a computer include such things as system programs, assemblers, compilers and operating systems, as well as programs for scientific calculations and statistical analysis.

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32. SUITE

A group of programs which carry out different tasks but are intended to work together, such as Microsoft Office (Word, Excel, Access, etc.).

33. TIME-SHARING

The use of a given device by a number of other devices, programs or human users, one at a time and in rapid succession. Time-sharing is also a technique or system for furnishing computing services to multiple users simultaneously, while providing rapid responses to each of the users. Time sharing computer systems usually employ multiprogramming and/or multiprocessing techniques, and they are often capable of serving users at remote locations via a data communications network.

34. UNIVERSAL SERIAL BUS (USB)

A standard type of connection port, used to attach extra devices such as a scanner to a computer. Currently, many PCs use USB to connect the mouse and keyboard.

35. WEBCAM

A digital camera capable of downloading images to a computer, for transmission over the Internet or other network.

36. WI-FI

(WIreless FIdelity) A method of connecting computers to a network without cables, using small radio transmitter/receivers built in to most portable devices and broadband modems.

K. CONSIGNMENT

A transfer of goods from the owner to another party, while still retaining ownership until the goods are sold, who will act as an agent for the owner in selling the goods. REF: BLACK'S.

L. CONSOLIDATED RETURN

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A federal income tax return which includes the operations of an affiliated group of corporations. REF: IRC § 1501-1505.

M. DISCOVERY

Pre-trial phase in a lawsuit in which each party, through the laws of civil procedure, can obtain evidence from the opposing party by means of discovery devices including requests for answers to interrogatories, requests for production of documents, requests for admissions and depositions. Discovery can be obtained from non-parties through the use of subpoenas. In Civil Court or in administrative hearings, discovery is the procedure by which either side obtains knowledge or possession of facts, titles, documents or other information to which the opposing party previously had exclusive knowledge or possession.

N. DIVISION

An operating unit within an enterprise which is not separately chartered. REF: BLACK'S.

O. DOMESTIC INTERNATIONAL SALES CORPORATION (DISC)

Commonly referred to as a DISC, this type of corporation was a pre-1985 system of federal tax deferral for export income. DISCs were held to be an export subsidy in violation of the General Agreement on Tariffs and Trade, and were generally replaced by a system of foreign sales corporations, FSCs. A DISC is a US corporation, usually a subsidiary, whose income is primarily attributable to exports. Income tax on a portion of the DISC's income is generally deferred for a long period.

P. ECONOMIES OF SCALE

The savings realized by related parties when an activity is performed on behalf of all parties. Centralized purchasing is a good example of this. Many times, items purchased for a number of companies from one vendor will allow that vendor to provide a substantially greater discount than could be allowed if each company purchased the same merchandise on its own. The savings realized by having a centralized purchasing operation is an example of economies of scale.

Q. ENTERTAINMENT INDUSTRY DEFINITIONS

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A listing of terms, which are commonly used by motion picture and film producers, their definitions and/or possible uses in auditing appear below.

1. ADVERTISING REPORT

   A report which lists information on films "in release".

2. DAILY SHOOTING SCHEDULES

   These schedules reflect what was done, who was there and how much time was spent on a specific project for a given day. The information on these schedules is useful in determining the location of payroll and property for the apportionment factors.

3. EMPLOYMENT CONTRACTS

   An agreement between employer and employee that identifies the responsibilities of both parties. These should be reviewed because, especially when major stars or writers are involved, they may specify the location where services must be performed.

4. FILM

   A film is a physical embodiment of a play, story or other literary, commercial, educational or artistic work (e.g. a motion picture, video tape, disk or other similar medium) except that it does not include news or sports film produced for telecast. Videocassettes or disks intended for home viewing are not considered films.

   Each episode of a series of films produced for television shall constitute a separate film even though the series relates to the same principle subject and is produced during one or more television seasons.

5. RELEASE

   There are many terms used in this business relating to the release of films.

6. IN RELEASE

   The date on which the amortization of a film begins. This date is also referred to in the motion picture industry as the "accounting release date".

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For films owned by a television network, "in release" means the date on which the film is first telecast.

7. RELEASE DATE

The date on which a film is placed in service. A film is placed in service when it is first telecast or exhibited to the primary audience for which the film was created. Thus, a motion picture theater film is placed in service when it is first publicly exhibited for entertainment purposes and an educational film is placed in service when it is first exhibited for instructional purposes. Each episode of a television series is placed in service when it is first telecast. A film is not placed in service merely because it is completed and therefore in a condition or state of readiness and availability for telecast or exhibition, or merely because it is telecast or exhibited to prospective exhibitors, sponsors, or purchasers, or is shown in a "sneak preview" before a select audience.

8. RE-RELEASE

The release of any film for general theatrical and foreign distribution, syndication, or television networks exhibition at any time after its initial distribution (release period) has terminated.

9. RATE CARD VALUES

Standard Rate and Data Services, Inc publish these values. The rate card values represent the amount of TV viewers receiving certain programs. The values are used to establish billing rates and allocate revenues to TV station affiliates.

10. RECEIPTS REPORT

This report will provide, on an annual basis, an accounting of payments of films' residuals.

11. SUBSCRIBER

A subscriber to a subscription television telecaster is the individual residence or other outlet, which is the ultimate recipient of the transmission.

12. SYNDICATION

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An association of individuals or a joint venture or short-term partnership, applied principally to a film-distribution operation, united for the prosecution of some enterprise requiring large amounts of capital. Its existence is often evidenced by an informal exchange of letters among participants, appointment of a manager with specified powers, transacting business and keeping an independent set of books under the manager's direction, and concluding with a windup of the business at hand and with a final distribution of the assets.

13. TELECAST

A telecast is the transmission of an electronic signal by radiowaves or microwaves or by wires, lines, coaxial cables, wave-guides or other tangible conduits of communication.

R. (FOREIGN CURRENCY) EXCHANGE GAIN/LOSS

An exchange gain or loss occurs when an accrual taxpayer has a transaction where the exchange rate between the taxpayer's currency and a foreign currency changes between the time a purchase or sale is consummated and the time of actual payment or receipt. Because transactions of this type may increase or decrease taxable income, the taxpayer's earnings must be adjusted to reflect the exchange gain or loss.

S. 52/53 WEEK TAXABLE YEAR

A taxable year that ends on the same day of the week every year. Therefore, it is always 52 or 53 weeks long. A 52/53 week year may end on the last specified day of the week that occurs during the final month of each taxable year (e.g., the last Saturday in December) or on the specified day of the week that is closest to the last day of the final month of each taxable year (e.g., the Sunday closest to June 30). For purposes of transition and effective date rules expressed in terms such as “for taxable years ending on or after” a certain date, a 52/53 week year is treated as ending on the last day of the month that is used to determine the end of the 52/53 week year and the next taxable year is treated as beginning on the first day of the next month. For example, a 52/53 week year ending Saturday, July 2, is treated as ending on June 30, and the next taxable year is treated as beginning on July 1, for transition rule and effective date purposes. REF: IRC § 441(f).

T. FOREIGN DIVIDEND GROSS-UP

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The amount included in a domestic parent's Federal Taxable Income for the taxes paid by a foreign subsidiary on the earnings this subsidiary generates. This gross-up is recognized only by companies electing to claim the Foreign Tax Credit.

For all taxable years ending after December 31, 1974, the gross-up is a subtraction modification used in computing Illinois base income. For years ending on or after December 31, 1982, the gross-up may be subtracted as a component of the Foreign Source Dividend Subtraction per Schedule J, IL-1120.

U. FOREIGN PERSON

Any person who is a nonresident alien individual and any non-individual entity organized under the laws of a country other than the United States.

V. FOREIGN SALES CORPORATION (FSC)

Corporations that meet certain federal requirements can elect, for years beginning after June 30, 1985, to be treated as a FSC. See Domestic International Sales Corporation (DISC). FSCs were held to be an export subsidy in violation of the General Agreement on Tariffs and Trade, and were replaced first by an “extraterritorial income” exclusion and then by the domestic production activities deduction in IRC § 199.

W. FORUM SHOPPING

The process of selecting the place of litigation, or the place where the issue will be pursued, that probably would result in a more favorable decision. REF: BLACK'S.

X. GENERAL INFORMATION LETTER (GIL)

Issued by the Department in response to written requests from taxpayers, taxpayer representatives, business, trade, or industrial associations, etc, to provide general discussions of tax principles and/or applications. Such letters do not constitute statements of agency policy and are not binding on the department. REF: IAC § 1200.120.

Y. HOLDING COMPANY

A corporation organized for the purpose of owning stock in and managing one or more corporations. Holding companies traditionally own many corporations in widely different business areas.

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Z. INTANGIBLE PROPERTY

Property, which has no intrinsic and marketable value, but is merely the representative or evidence of value, such as certificates of stock, bonds, promissory notes and franchises. REF: BLACK'S.

AA. INTEGRATION

1) Horizontal - Occurs when a corporation or a group of corporations are in the same general line of business. For example, a nationwide chain of manufacturing concerns would be a horizontally integrated organization.

2) Vertical - This type of integration occurs when a corporation or a group of corporations are engaged in different steps leading to the completion of a final product.

BB. INTERCOMPANY ITEMS

Increases and decreases in financial statement accounts related to transactions between members of a common group.

CC. INTERSTATE COMMERCE

Traffic, commercial trading or the transportation of persons or property between or among the several states, or from or between points in one state and points in another state; commerce between places lying in different states. REF: BLACK'S.

DD. INTRASTATE COMMERCE

Traffic, commercial trading or the transportation of persons or property, which is started, carried on, and completed entirely within the limits of a single state. REF: BLACK'S.

EE. JOINT VENTURE

A legal entity, in the nature of a partnership, engaged in the joint prosecution of a particular transaction for mutual profit. An association of persons jointly undertaking some commercial enterprise. It requires a community of interest in the performance of the subject matter, a right to direct and govern the policy in connection therewith, and duty, which may be altered by agreement, to share both in profit and losses. A one-time grouping of two or more persons in a business undertaking. Unlike a partnership, a joint venture does not entail a

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continuing relationship among the parties. A joint venture is treated like a partnership for federal [and Illinois] income tax purposes. REF: BLACK'S.

FF. JURAT STATEMENT

A statement made under penalty of perjury, attesting to the accuracy of a return or other filing.

GG. LIMITED LIABILITY COMPANIES

Unincorporated associations of one or more members that may transact any lawful business that a corporation, general partnership, limited partnership, or other business entity may conduct, except, generally, banking or insurance. A limited liability company's powers are similar to those of a general corporation but it may elect to enjoy the tax benefits normally associated with a partnership or an S-corporation or, if it has only one member, to be disregarded as an entity separate from its member. REF: 805 ILCS 180/1-1 et seq.

HH. MANUFACTURER

A person or organization producing finished goods from the raw material to the final product. One who employs capital, equipment and labor in the production or assembly of manufactured articles.

II. MEDICAL CANNABIS DEFINITIONS

The following is a list of terms (non-inclusive) used in connection with the Compassionate Use of Medical Cannabis Pilot Program Act.

1. CANNABIS

Has the meaning given that term in Section 3 of the Cannabis Control Act [720 ILCS 550/3(a)] as follows:

"Cannabis" includes marihuana, hashish and other substances which are identified as including any parts of the plant Cannabis Sativa, whether growing or not; the seeds thereof, the resin extracted from any part of such plant; and any compound, manufacture, salt, derivative, mixture, or preparation of such plant, its seeds, or resin, including tetrahydrocannabinol (THC) and all other cannabinol

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derivatives, including its naturally occurring or synthetically produced ingredients, whether produced directly or indirectly by extraction, or independently by means of chemical synthesis or by a combination of extraction and chemical synthesis; but shall not include the mature stalks of such plant, fiber produced from such stalks, oil or cake made from the seeds of such plant, any other compound, manufacture, salt, derivative, mixture, or preparation of such mature stalks (except the resin extracted therefrom), fiber, oil or cake, or the sterilized seed of such plant which is incapable of germination.

2. MEDICAL CANNABIS

Cannabis and its constituent cannabinoids, such as tetrahydrocannabinol (THC) and cannabidiol (CBD), used as an herbal remedy or therapy to treat disease or alleviate symptoms. Medical cannabis can be administered by a variety of routes, including, but not limited to: vaporizing or smoking dried buds; administering tinctures or tonics; applying topicals such as ointments or balms; consuming infused food products, such as soda or teas; or taking capsules. [86 IL. Admin. Code 429.105]

3. MEDICAL CANNABIS CULTIVATION CENTER

A facility operated by an organization or business that is registered by the Department of Agriculture to perform necessary activities to provide only registered medical cannabis dispensing organizations with usable medical cannabis.

4. MEDICAL CANNABIS DISPENSING ORGANIZATION (or DISPENSING ORGANIZATION or DISPENSARY ORGANIZATION)

A facility operated by an organization or business that is registered by the Department of Financial and Professional Regulation to acquire medical cannabis from a registered cultivation center for the purpose of dispensing cannabis, paraphernalia, or related supplies and educational materials to registered qualifying patients.

5. ORGANIZATION REGISTRANT

A corporation, partnership, trust, limited liability company (LLC), or other organization, but not an individual, that holds either a medical cannabis cultivation center registration issued by the Department of Agriculture or a medical cannabis dispensary registration issued by the Department of Financial and Professional Regulation. [86 IL. Admin. Code 100.2060]

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6. SURCHARGE

This amount is equal to the amount of federal income tax liability for the taxable year attributable to the "transactions subject to the surcharge" (see next definition).

7. TRANSACTIONS SUBJECT TO THE SURCHARGE

Sales and exchanges of capital assets, depreciable business property, and real property used in the trade or business, and Section 197 intangibles of an organization registrant. Ref: IITA § 201(o).

JJ. MINING

Refer to Chapter 36 for a definition of mining.

KK. NEXUS

Nexus is used to describe the degree of business activity that must be present before a jurisdiction has the right to impose a tax on a person's income. The criteria for establishing nexus for any specific entity is dependent upon the business nature of the entity involved. See Income Tax Audit Manual chapter 22 for more information.

LL. NONRESIDENT

Any person that is not considered a resident under the provisions of Section 1501(a)(20) is considered a nonresident. Because only individuals, trusts and estates are included in the definition of "resident", corporations and partnerships are always nonresidents. For individuals, there is a presumption of residency in effect that may be overcome by satisfactory evidence that the person's presence in Illinois was for a temporary or transitory purpose only. The type or amount of proof, which is required to support a claim of non-residency, is discussed in IAC § 100.3020.

MM. NOTICE AND DEMAND

1. ILLINOIS INCOME TAX ACT

A statutory notice for a tax liability that is deemed assessed and which is issued in accordance with IITA § 902. A Notice and Demand is issued for tax

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due on an original return, or when there is no timely protest filed following a Notice of Deficiency.

2. UNIFORM PENALTY AND INTEREST ACT

The term "notice and demand" as it is used in Sections 3-2 and 3-3 of the Uniform Penalty and Interest Act is somewhat broader in scope than the IITA definition of "notice and demand." Section 3-2 of the UPIA allows a taxpayer to pay the amount shown due on a notice and demand within 30 days (21 days, for notices issued prior to January 1, 1996) from the date the notice was issued without additional interest accruing from the date of the notice. Section 3-3 of the UPIA allows a taxpayer a 30-day (21 days, for notices issued prior to January 1, 1996) period after the issuance of a "notice and demand" for payment in which to pay the tax shown due on the notice, before a late payment penalty will be incurred or released.

The term "notice and demand" is not defined in the UPIA or used in any tax act other than the UPIA and the IITA. Since the UPIA is applicable to virtually all tax acts that the Department administers, it is presumed that the legislature intended the term "notice and demand" to have a more-generic meaning than when used specifically in the IITA. Accordingly, the term "notice and demand" - when used with regard to the UPIA § 3-2 interest and § 3-3 penalty - has been interpreted by the Department to include other types of notifications of tax liability issued to taxpayers, in addition to an IITA Section 902 notice and demand, whether the type of notification may be proposed, protestable or non-protestable. The Department has not been consistent in its interpretation. For example, protestable notices triggered the 30-day grace period for payment of interest until GenTax was implemented for the various taxes, and the 30-day grace period was no longer triggered by any protestable notice except for income tax notices of deficiency. It was subsequently decided that, in order to provide uniform treatment across tax types, the grace period would no longer be allowed for notices of deficiency.

NN. NOTICE OF DEFICIENCY

A statutory notice for tax issued under IITA § 904 that sets forth the adjustments giving rise to a proposed assessment. Upon the expiration of 60 days after the date on which it is issued (150 days if the taxpayer is outside the United States), a Notice of Deficiency will constitute an assessment of the amount of tax and specified penalties if the taxpayer fails to file a protest with the Department, as provided in IITA § 908.

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OO. OIL AND GAS INDUSTRY DEFINITIONS

The following is a list of terms that are commonly used when dealing with the oil and gas industry. The list is **purposely not in alphabetical order** due to several of the definitions building upon the preceding terms.

1. FEEDSTOCK

Raw material used for industrial processing such as any of a variety of petroleum products used in making petrochemicals.

2. ECONOMIC INTEREST

This term is used frequently in determining who is entitled to certain deductions such as depletion. It is a difficult term to accurately define however, IRC §1.611-1(b)(1) may be used as a guide.

3. WORKING/OPERATING INTEREST

Interest acquired in oil and gas properties by a lessee and/or operator is known as WORKING or OPERATING interest. It is also referred at times as an operating mineral interest. A working interest is burdened with the costs of development and operation of the property.

4. OPERATING AGREEMENT

An agreement between the co-owners of a working interest to drill, develop and operate the property is called an operating agreement. Standard agreement forms are used in the industry, which identify the property, the co-owners and their share of the working interest. It will also contain several clauses spelling out the rights, duties and obligations of the parties. An accounting agreement is also appended to this document.

The determination of whether the agreement constitutes an association that is taxable as a corporation or a partnership will be made at the federal level. This determination depends on the presence of the basic corporate attributes, including centralization of management and continuity of existence. REF: Sunshine Letter IT89-0261.

5. OPERATOR

The entity, which carries on the day-to-day physical operation of an oil or gas property, is called an operator. An operator normally has a working interest in the property.

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6. CARRIED INTEREST

Two or more co-owners of a working interest may agree that one co-owner (the carrying party) will advance some or all of the development costs on behalf of the others (the carried parties) and recoup such advances from the other owners' share of oil and gas if and when produced from the property. The carrying party's interest, which arises from this arrangement, is known as carried interest.

7. PAYOUT AND PAYOUT PERIOD

The recoupment of the cost by the carrying party and the period during which it is recouped is known as the payout and the payout period, respectively.

8. GROSS INCOME FROM THE PROPERTY

The IRS regulations define gross income as "the amount for which the taxpayer sells the oil or gas in the immediate vicinity of the well". If the oil is transported from the premises prior to sale then the gross income is determined by reference to representative market or field price (see 10. Posted Price/Field Price below) REF: Reg. Sec. 1.613-3(a). If the purchase contract contains provisions for freight equalization, gathering, transportation and hauling charges, the US Tax Courts have generally held that these charges are excluded from the gross income figure.

9. TAXABLE INCOME FROM THE PROPERTY

Taxable income from the property is used to compute percentage depletion. It is defined in IRC § 613(a) as gross income from the property less allowable deductions (other than depletion) attributable to the property. Allowable deductions include administrative and financial overhead, operating expenses, selling expenses, depreciation, taxes, losses sustained, etc, and intangible drilling and development costs which have been expensed.

10. POSTED PRICE/FIELD PRICE

Posted or field prices are those generally made known throughout the industry for the buying of crude oil. These are the prices the buyers are willing to pay, to anyone, in a particular field. Posted prices are adjusted to reflect any increase or decrease in the market price. Posted prices are often based on the product transported to a marketing point or converted. Transfers at posted prices, therefore, reflect arms-length transactions. In addition to establishing transfer prices, the posted prices (of non-transported

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and unrefined products) also determine royalties payable to private and government landowners, the amount of state severance and production taxes payable, the amount of windfall tax payable and the amount of allowable depletion for Federal income tax purposes.

11. WELLHEAD PRICE

This is the price at which the unrefined product is sold at the wellhead or in the immediate vicinity of the well. This price is the same as the posted or field price of the crude at the well location. The terms wellhead price, posted price and field price are frequently used interchangeably.

PP. PARENT CORPORATION

A company which owns more than 50% of the voting shares of another company. A parent corporation is one, which has working control through stock ownership of its subsidiary corporations. REF: BLACK'S.

QQ. PARTNER - GENERAL

In a partnership, a partner whose liability is not limited. All partners in an ordinary partnership are general partners. A limited partnership must have at least one general partner.

RR. PARTNER - LIMITED

A partner whose participation in the management and profits is limited by the agreement and who is not liable for the debts of the partnership beyond his/her capital contribution.

SS. PARTNERS - DORMANT

Those names that are not known or do not appear as partners, but who nevertheless are silent partners, and partake of the profits, and thereby become partners, either absolutely to all intents and purposes, or at all events in respect to third parties. Dormant partners, in strictness of language, mean those who are merely passive in the firm, whether known or unknown, in contradistinction to those who are active and conduct the business of the firm, as principals. REF: BLACK'S.

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TT. PARTNERSHIP - GENERAL

A partnership in which the parties carry on all their trade and business, whatever it may be, for the joint benefit and profit of all the parties concerned, whether the capital stock be limited or not, or the contributions thereto be equal or unequal. One in which all the partners share the profits and losses as well as the management equally, though their capital contributions may vary. REF: BLACK'S.

UU. PARTNERSHIP - LIMITED

A partnership consisting of one or more general partners, jointly and severally responsible as ordinary partners, and by whom the business is conducted, and one or more special partners, contributing in cash payments a specific sum as capital to the common stock, and who are not liable for the debts of the partnership beyond the fund so contributed. REF: BLACK'S.

VV. PERSONAL HOLDING COMPANY

A personal holding company is any corporation (other than the exceptions below) if:

1) At least 60% of adjusted ordinary gross income for the tax year is personal holding company income as described in IRC § 543, and

2) At any time during the last half of the tax year more than 50% in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals using the constructive ownership rules of IRC § 544.

However, the term "personal holding company" does not include:

- A corporation exempt from tax under IRC § 501.
- A bank as defined in IRC § 581 or a domestic building and loan association.
- A life insurance company.
- A surety company.
- A foreign personal holding company (as defined in IRC § 552).
- Some lending and finance companies if they meet prescribed tests as to the source or amount of their interest income and the amount of loans to stockholders.
- A foreign corporation, ALL of whose outstanding stock during the last half of the tax year is owned by nonresident alien individuals directly or indirectly through foreign estates, trusts, partnerships, or other foreign corporations.

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- A small business investment company (unless a shareholder, directly or indirectly owns five percent or more of a concern to which the company supplies funds).
- A corporation subject to the jurisdiction of a court in a bankruptcy or similar proceeding unless the case was started to avoid the tax.
- A passive foreign investment company as defined in IRC § 542(c). REF: IRC § 542.

WW. PERSONAL SERVICE CORPORATION

A corporation (for purposes of a tax year) is a personal service corporation if:

1) It is a C corporation (as defined in IRC § 1361(a)(2)) for the tax year.
2) Its principal activity during the testing period for the tax year is the performance of personal services.
3) Such services are substantially performed by employee-owners during the testing period for the tax year, and
4) Employee-owners own more than 10% of the fair market value of the outstanding stock in the corporation on the last day of the testing period for the tax year.

The testing period for a tax year is generally the preceding tax year.

If a corporation is a member of an affiliated group filing a consolidated return, all members of such group must be taken into account in determining whether such corporation is a personal service corporation.

A personal service corporation must generally have a calendar tax year unless special permission is granted. REF: IRC § 441.

XX. PRIMA FACIE

A fact, which is presumed to be true unless, disproved by some evidence to the contrary. REF: BLACK'S

YY. PRIMA FACIE EVIDENCE

Evidence good and sufficient to establish a given fact, or chain of facts, constituting the party's claim or defense and which, if not rebutted or contradicted, will remain sufficient. REF: BLACK'S.

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ZZ. PRIVATE LETTER RULING (PLR)

Issued to a specific taxpayer concerning the application of a tax statute or rule to a specific fact situation which is binding on the department only for the taxpayer to whom it is issued. Every letter ruling is revoked on the date that is 10 years after the date of issuance of the ruling or July 1, 2002, whichever is later. REF: IAC § 1200.110(e).

AAA. PROTEST ACT

Allows a taxpayer to pay tax and file an injunction, which prevents the Department from putting the money in the General Revenue Fund until the case is settled. It also allows the taxpayer to go directly to a circuit court for decisions. The actual act is titled the State Officers and Employees Money Disposition Act and can be found at 30 ILCS Act 230.

BBB. PUBLIC LAW 86-272

Provides that a state cannot impose an income tax on a person if its only business activity in a given state is the solicitation of sales of tangible property if such orders are approved and filled by shipment or delivery from a point outside the state in question. Discussed in detail in chapter 22.

CCC. RETAILING

Sale for final consumption, rather than for resale, or for further processing.

DDD. REVERSIONARY SALES

Refer to chapter 27 relating to the Throwback Rule.

EEE. SAFE HARBOR LEASES

A transaction, which qualifies under IRS, rules to be treated as a lease rather than the financing arrangement of a sale.

FFF. SUBSIDIARY

A company whose voting stock is more than 50% owned by another firm.

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GGG. TANGIBLE PERSONAL PROPERTY

Personal property, which may be seen, weighed, measured, felt, touched, or in any way is perceptible to the senses. REF: BLACK'S.

HHH. UNITED STATES

The phrase "United States" means only the 50 states and the District of Columbia, but for purposes of applying the 80/20 test to determine if a taxpayer may be included in a unitary business group, does not include members operating in any territory or possession of the United States. REF: IITA § 1501(a)(27) and IAC § 100.9700(c)(2)(A).

PA 100-022 changed this definition of “United States” to now include any area over which the United States has asserted jurisdiction or claimed exclusive rights with respect to the exploration for or exploitation of natural resources (i.e., the outercontinental shelf).

V. FEDERAL DEFINITIONS (12 CFR § 1813)

DEPOSIT (1813(l))

1. The unpaid balance of money or its equivalent received or held by a bank or savings association in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time or thrift account, or which is evidenced by its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a check or draft drawn against a deposit account and certified by the bank or savings association, or a letter of credit or a traveler’s check on which the bank or savings association is primarily liable.

2. Trust funds as defined in this Act received or held by such bank or savings association, whether held in the trust department or held or deposited in any other department of such bank or savings association.

3. Money received or held by a bank or savings association, or the credit given for money or its equivalent received or held by a bank or savings association, in the usual course of business for a special or specific purpose

4. Outstanding draft (including advice or authorization to charge a bank’s or a savings association’s balance in another bank or savings association) cashier’s check, money order, or other officer’s check issued in the usual course of

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business for any purpose, including without being limited to those issued in payment for services, dividends, or purchases, and

5. Such other obligations of a bank or savings association as the Board of Directors, after consultation with the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System, shall find and prescribe by regulation to be deposit liabilities by general usage, except that the following shall not be a deposit for any of the purposes of this Act or be included as part of the total deposits or of an insured deposit:

   (A) any obligation of a depository institution which is carried on the books and records of an office of such bank or savings association located outside of any State, unless—

   (i) such obligation would be a deposit if it were carried on the books and records of the depository institution, and would be payable at, an office located in any State; and
   (ii) the contract evidencing the obligation provides by express terms, and not by implication, for payment at an office of the depository institution located in any State;

   (B)any international banking facility deposit, including an international banking facility time deposit, as such term is from time to time defined by the Board of Governors of the Federal Reserve System in regulation D or any successor regulation issued by the Board of Governors of the Federal Reserve System; and

   (C) any liability of an insured depository institution that arises under an annuity contract, the income of which is tax deferred under section 72 of the Internal Revenue Code of 1986 (Annuities; certain proceeds of endowment and life insurance contracts).

NOTE: This information is being added given that the Federal definition was utilized by audit staff in relation to Investment Partnerships “qualifying investment securities”.

VI. ACRONYMS

Acronyms are used extensively by the Department of Revenue, the Bureau of Audits and taxpayers. A listing of the more commonly used acronyms and their meanings follow.

Acronym	Definition
ABB	Audit Bureau Bulletin
ACS	Automated Calling System

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AGI	Adjusted Gross Income
AMU	Audit Manual Update
APB	Accounting Principles Board
APE	Account Period Ending
APTS	Audit Planning/Technical Support
ARB	Accounting Research Bulletins
ART	Automobile Renting Tax
BCI	Bureau of Criminal Investigations
BIT	Business Income Tax
BOA	Board of Appeals
BPD	Business Processing Division
CAA	Computer Assisted Audit
CASB	Cost Accounting Standards Board
CID	Criminal Investigation Division
CIT	Corporate Income Tax
CMFT	County Motor Fuel Tax
COAD	Coin Operated Amusement Devices
CRM	Customer Relationship Management (Notes on accounts in GenTax)
CROT	County Retailers' Occupation Tax
CSR	Computer System Retrieval
COST	County Service Occupation Tax
DC&D	Document Control and Deposit (Section)
DOR	Department of Revenue
EFT	Electronic Funds Transfer
FAM	Field Audit Manager (Bureau of Audits)
FASB	Financial Accounting Standards Board
FEIN	Federal Employer's Identification Number
FSEU	Federal/State Exchange Unit
FTI	Federal Taxable Income
FY	Fiscal Year
GIL	General Information Letter
GRF	General Revenue Fund
I: #	Legal memo contained in the pre-Sunshine Act, Income Tax Research Manual
IA	Internal Audit and Internal Affairs
IAC	Illinois Administrative Code
IBT	Illinois Business Tax (Number)--Used by the computer systems as an identifying number.
ICT	Invested Capital Tax
IDOR	Illinois Department of Revenue
IFTA	International Fuel Tax Agreement
IIT	Individual Income Tax
IITA	Illinois Income Tax Act
ILP	GenTax Production Environment

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ILS	GenTax Staging Environment (final test region)
ILT	GenTax Test Environment
INLD	Illinois Net Loss Deduction
IPD	Individual Processing Division
IRC	Internal Revenue Code
ITIB #	Income Tax Informational Bulletin (predecessor to the current FY Information Bulletins)
ITLD-S	Income Tax Legal Division--Springfield (Legal Services)
JCAR	Joint Committee on Administrative Rules--Committee made up of Members from the House and Senate that review proposed rules that interpret the tax laws (the Regulations).
JRTC	James R Thompson Center, Chicago
KOB	Kind of Business (Codes)
LAN	Local Area Network (computers)
LLC	Limited Liability Companies
LUST	Leaking Underground Storage Tanks (Tax)
MAC	Management Advisory Committee (Sales Tax Reform Issues)
MFT	Motor Fuel Tax
MFUT	Motor Fuel Use Tax
MIS	Management Information System
MROT	Municipal Retailers' Occupation Tax
MSOT	Municipal Service Occupation Tax
MTC	Multistate Tax Commission
MVUT	Motor Vehicle Use Tax
NOL	Net Operating Loss
NOLD	Net Operating Loss Deduction
NSF	Non-Sufficient Funds (Bad Check)
OPM	Office of Publications Management
OID	Original Issue Discount
OIS	Operational information System
P&I	Penalty and Interest
PA #	Public Act
PC	Personal Computers
PL #	Public Law (federal law)
PLR	Private Letter Ruling
PRD	Problem Resolution Division
PST	Prepaid Sales Tax
PVUT	Private Vehicle Use Tax
RA	Revenue Auditor (I, II, III) (Bureau of Audits)
RAD	Revenue Accounting Division
RAS	Revenue Audit Supervisor (Bureau of Audits)
RCN	Return Correction Notice
ROT	Retailers' Occupation Tax
RT	Personal Property Tax Replacement Income Tax (Replacement Tax)

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RTA	Regional Transportation Authority
SEC	Securities and Exchange Commission
SOA	Statement of Account
SOT	Service Occupation Tax
SQR	Solution Request (GenTax problem reporting system)
SSN	Social Security Number
STPD	Sales Tax Processing Division
TAM	Technical Advice Memo (Intradepartmental memos issued by Legal Services)
TIF	Tax Increment Financing
TIN	Tax Identification Number (either a FEIN or SSN)
TPN	Taxpayer Notice
TR	Technical Response (Bureau of Audits)
TRS	Taxpayer Records Section
TSR	Taxpayer Service Representatives
TSS	Technical Support Section (Bureau of Audits)
TPA	Tax Processing Administration
UBG	Unitary Business Group
UDITPA	Uniform Division of Income Tax Purposes Act (This is the model Act for apportioning and allocating income on which the Illinois Income Tax Act apportionment provisions are based.)
UPIA	Uniform Penalty and Interest Act
UT	Use Tax
WIB	Willard Ice Building
WIT	Withholding Income Tax

VII. US TREASURY AND AGENCY ACRONYMS

Some of the more commonly used acronyms relating to government and government agencies' securities are listed below. This information was obtained through various sunshine letters, which have been issued. This list is not all US Treasury – refer to Publication 101 for approved US Treasury obligations that qualify for the subtraction modification.

CATS	Certificates of Accrual on Treasury Securities
FNMA	Federal National Mortgage Association
GNMA	Government National Mortgage Association
STRIPS	Separate Trading of Registered Interest and Principal of Securities
TIGERS	Treasury Investment Growth Receipts Securities
FREDDIE MAC	Federal Home Loan Mortgage Corporation

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VIII. REFERENCE SOURCES AND MATERIALS

In addition to the reference sources available at the Illinois Department of Revenue, the following sources can be found at the Illinois State Library, most college and university libraries and other major libraries. Most reference sources may now be accessed through the Internet. A brief explanation of the type of informational material is also included in the listing.

Many of the following referenced below can be found in the Legal Services library in the Willard Ice Building.

A. ALL STATE TAX GUIDE (PRENTICE HALL)

Contains key facts on all state taxes, which are compiled for easy reference.

B. AMERICA'S CORPORATE FAMILIES/THE BILLION DOLLAR DIRECTORY (DUN AND BRADSTREET)

Provides information on parent companies including divisional and subsidiary information. Also contains cross-references of division and subsidiary names to the Parent Corporation.

C. BLACK'S LAW DICTIONARY

Contains definitions of legal terms. The copy in the Legal Services library is the 4th edition, copyright 1968.

D. CORPORATE TAX DIGEST (WARREN, GORHAM AND LAMONT)

A comprehensive reference to federal corporate tax rulings and tax cases since 1954.

E. DIRECTORY OF CORPORATE AFFILIATIONS; WHO OWNS WHOM

Lists parent companies, identifying their divisions, subsidiaries and foreign affiliates. Cross-references divisions, subsidiaries and foreign affiliates to their parent companies. Also includes an annual list of mergers, acquisitions and name changes.

F. DIRECTORY OF FOREIGN FIRMS OPERATING IN THE UNITED STATES

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Includes a listing of American-based firms owned wholly or in part by foreign firms. The information is arranged by country and by American subsidiaries, branches or affiliates.

G. F & S INDEX

Half of this index is devoted to product and industry information appearing in industry journals and business periodicals.

H. FEDERAL TAX COORDINATOR (RIA)

Numerous volumes containing an interpretation of federal tax laws, IRS Rulings, and federal tax cases as compiled and published by the Research Institute of America. The copy in the Legal Services library is kept up to date.

I. FEDERAL TAX REPORTER (CCH)

Numerous volumes containing an interpretation of federal tax laws, IRS Rulings, and federal tax cases as compiled and published by Commerce Clearing House.

J. FEDERAL TAXATION OF CORPORATIONS & SHAREHOLDERS, BY BORIS L. BITTKER AND JAMES S. EUSTICE

A single volume, which presents the structures and activities of corporations and shareholders with the application of federal tax, law. The copy in the Legal Services library was last updated in 2004.

K. ILLINOIS TAX REPORTER (CCH)

A two volume set that provides current information regarding Illinois legislation, current regulations and court cases. The copy in the Legal Services library was last updated in 1994.

L. LAW OF FEDERAL INCOME TAXATION (MERTENS)

A legal library of federal taxation that contains sets of volumes on tax rulings published by year, tax regulations published by year and federal tax laws. The copy in the Legal Services library was last updated in 1989.

M. MOODY'S MANUALS

(i.e. Industrials, Public Utility, Accumulative Dividend Records, Bank and Financial, Transportation, Stock Survey, Bond Survey, News Report, Over the Counter)

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Information will include acquisitions and disposals, subsidiaries, products and customers, major properties and product lines, locations of operations, etc.

N. MULTISTATE CORPORATE INCOME TAX GUIDE (CCH)

The corporate Income Tax laws in all states that impose an income tax or have a tax that is measured by corporate income. Filled-in examples of various tax forms are also included. The copy in the Legal Services library was last updated in 1996.

O. MULTISTATE CORPORATE TAX ALMANAC

A semi-annual publication that provides easy access to each state's current position on key issues in corporate taxation (such as unitary requirements, business v. non-business income, foreign sales corporations, components of the apportionment formula, nexus, etc).

P. STANDARD & POOR'S

(I.e. Corporation Records, Standard NYSE Stock Reports)--Information will include corporate background, bond descriptions, stock data, financial data, important developments, etc.

Q. STATE TAXATION

"Corporate Income and Franchise Taxes", by Jerome R. Hellerstein--A commentary on key issues involved in state taxation and "Corporate Income and Franchise Taxes"—1988 Cumulative Supplement, by Jerome R. Hellerstein and Walter Hellerstein--Supplement and continuation of the former. The copy in the Legal Services library was last updated in 2001.

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MAJOR LEGISLATION CHANGES

The following information is a list of the amendments to the various sections of the Illinois Income Tax Act since its inception on August 1, 1969 by PA 76-261. The list contains the original effective dates of each of the sections and the effective dates of any amendments. The list contains the major law changes through any bills signed as of December 14, 2019. Detailed information regarding the sections and any amendments can be found in the topical paragraphs, which are referenced at the end of the sections.

The references contained in the information below are to the CURRENT sections of the IITA. The original sections, if different from the current sections, are identified in the comment section of the Public Act, which created the section. Any transitional section numbers have been excluded.

Many Public Acts have multiple effective dates. In the listing below the effective date of the amendment to the specific section involved is identified.

PA 87-205, which was signed into law on September 3, 1991, created the Uniform Penalty and Interest Act (UPIA). The UPIA becomes effective January 1, 1993. PA 87-1189 delayed the effective date of the UPIA until January 1, 1994. The legislative history of the UPIA is included at the end of this chapter.

ILLINOIS INCOME TAX ACT
35 ILCS 5/101 et seq.
FROM: IL REVISED STATUTES CH. 120 PARA. 1-101 et seq.

SECTION 101--SHORT TITLE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments

SECTION 102--CONSTRUCTION

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 76-2405 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Makes IRC and statutes applicable as they existed on January 1, 1970.

PUBLIC ACT 77-726 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1971

Makes IRC and laws applicable as in effect for the taxable year.

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SECTION 103--RENUMBERED INTERNAL REVENUE CODE PROVISIONS

CREATED BY:

PUBLIC ACT 81-1405 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1980

AMENDED BY:

PUBLIC ACT 86-678 - EFFECTIVE: SEPTEMBER 1, 1989

References to the Internal Revenue Code of 1954 were amended to refer only to the Internal Revenue Code.

SECTION 201--TAX IMPOSED

SECTION 201(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments.

SECTION 201(b)--RATES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Added: Rates specified in subsection (b) apply to tax imposed BY SUBSECTION (a). (This was due to the enactment of the Replacement Tax provisions in subsection (c) and (d).)

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Amended: Subsections (b)(1) and (b)(2) (changed to (b)(6)).
Added: Subsections (b)(2)(new), (b)(2)(i) and (ii), (b)(3), (b)(4), (b)(4)(i) and (ii), (b)(5), (b)(7), (b)(7)(i) and (ii), (b)(8), (b)(9), (b)(9)(i) and (ii), and (b)(10).

Amendments related to a temporary Income Tax rate increase to 3% for individuals, trusts and estates and 4.8% for corporations. The rate increase was in effect for the period of January 1, 1983 to June 30, 1984. For tax years that began prior to January 1, 1983 or ended after June 30, 1984, the increased rate was applied to income, which was prorated for the number of days of the tax year falling within the rate increase period.

PUBLIC ACT 84-604 - EFFECTIVE: SEPTEMBER 19, 1985

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Deleted: All subsections created by PA 83-14. Amended: Subsections (b)(1) and (b)(6) to delete references to Income Tax rate increase. Renumbered subsection (b)(6) to current (b)(2).

PUBLIC ACT 86-18 - EFFECTIVE: JULY 5, 1989

Added subsections relating to the temporary tax rate increase, which is in effect for July 1, 1989 to June 30, 1991. The increased rate is 3% for individuals, trusts and estates and 4.8% for corporations.

PUBLIC ACT 87-17 - EFFECTIVE: RETROACTIVE TO JULY 1, 1991

Amended the subsections necessary to extend the temporary tax increase to July 1, 1993. Further amended the subsections to state that, beginning on July 1, 1993, the permanent tax rate is 2.75% for individuals, trusts and estates and 4.4% for corporations.

PUBLIC ACT 88-89 - EFFECTIVE: JULY 1, 1993

Amended the subsections necessary to permanently set the Income Tax rate at 4.8% for corporations and 3% for individuals, trusts and estates.

PUBLIC ACT 91-643 - EFFECTIVE: AUGUST 20, 1999 FOR TAX YEARS BEGINNING ON OR AFTER DECEMBER 31, 1999

Added a provision to provide that, if required by subsection (d-1), the tax imposed by subsection (a) will be adjusted.

PUBLIC ACT 96-1496 – EFFECTIVE: JANUARY 13, 2011

Added paragraphs 4 through 5.4 to change the individual, trust and estate rate to 5% for income earned after December 31, 2010 and prior to January 1, 2015, to 3.75% after December 31, 2014, and prior to January 1, 2025, and to 3.25% after December 31, 2024. Added paragraphs 9 through 14 to raise the corporate rate to 7% for income earned after December 31, 2010, and prior to January 1, 2015, to 5.25% after December 31, 2014, and prior to January 1, 2025 and to 4.8% after December 31, 2024.

PUBLIC ACT 100-22 – EFFECTIVE: JULY 6, 2017

Amended paragraphs 5.2, 5.3, 5.4, 12, 13 and 14 to change the individual, trust and estate rate to 4.95% for income earned after June 30, 2017 and to change the corporate rate to 7% for income earned after June 30, 2017.

SECTION 201(b-5) – GAMING SURCHARGE

CREATED BY:

PUBLIC ACT 101-31 – EFFECTIVE: June 28, 2019

Imposes a surcharge on gains realized on capital assets and assets used in business by licensees under the Horse Racing Act of 1975 or the Illinois Gambling Act, equal to the federal income tax on the gains.

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SECTION 201(c)--REPLACEMENT TAX IMPOSED

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JULY 1, 1979

AMENDED BY:

PUBLIC ACT 83-1352 - EFFECTIVE: SEPTEMBER 8, 1984

Substituted references to "corporations for which there is in effect for the taxable year an election under Section 1372 of the Internal Revenue Code" with references to "Subchapter S corporations."

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Adds the heading “Personal Property Tax Replacement Income Tax” to the beginning of the paragraph.

SECTION 201(d)--REPLACEMENT TAX RATES

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JULY 1, 1979

AMENDED BY:

PUBLIC ACT 83-1352 - EFFECTIVE: SEPTEMBER 8, 1984

Substituted references to "a corporation for which there is in effect for the taxable year an election under Section 1372 of the Internal Revenue Code" with references to "a Subchapter S corporation."

PUBLIC ACT 91-643 - EFFECTIVE: AUGUST 20, 1999 FOR TAX YEARS BEGINNING ON OR AFTER DECEMBER 31, 1999

Added a provision to provide that, if required by subsection (d-1), the Personal Property Tax Replacement Income Tax imposed by subsection (c) and (d) will be adjusted.

SECTION 201(d-1)--RATE REDUCTION FOR CERTAIN FOREIGN INSURERS

CREATED BY:

PUBLIC ACT 91-643 - EFFECTIVE: AUGUST 20, 1999 FOR TAX YEARS BEGINNING ON OR AFTER DECEMBER 31, 1999 AND ENDING WITH TAX YEARS ENDING ON OR BEFORE DECEMBER 31, 2000

Provides that in the case of a foreign insurer (an out-of-state insurance company), for certain tax years, the sum of the rate of the corporate income tax and the personal property tax replacement income tax must be reduced to the rate of tax imposed on and measured by net income by the state or country in which the insurer is domiciled. It provides that the reduction may not reduce the sum of the tax rates to an amount that causes the total amount of taxes due from a foreign insurer for any taxable year to be less than the amount of certain taxes plus 1.25% of the net taxable premiums written by the insurer. It also provides that the reduction may not result in the increase of the sum of

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the rates of tax imposed on a foreign insurer. This legislation will benefit a few domestic insurance companies by reducing the amount of “retaliatory” tax they have to pay to other states. It has a sunset provision effective on January 1, 2001.

AMENDED BY:

PUBLIC ACT 91-860 - EFFECTIVE: JUNE 22, 2000

For purposes of calculating the rate reduction allowed to certain foreign insurers, it provides that premiums from reinsurance do not include premiums from inter-affiliate reinsurance arrangements. In addition, it eliminates the original two-year sunset provision and now exempts this subsection from the sunset provisions of Section 250 of the IITA.

PUBLIC ACT 93-029 - EFFECTIVE: JUNE 20, 2003

Amends subsection (1)(B) to set the floor amount for taxes on the foreign insurer for taxable years ending on or after December 31, 2003, at 1.75% of net taxable premiums rather than 1.25%.

SECTION 201(e)--REPLACEMENT TAX PRORATION OF INCOME--DELETED

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JULY 1, 1979

Allowed taxpayers with taxable years, which began prior to July 1, 1979 or ended after June 30, 1979 to elect to prorate their income for purposes of computing their Replacement Tax liability by either using the number of days method (subsection (e)(1)) or the specific accounting method (subsection (e)(2)).

DELETED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

SECTION 201(f)--REPLACEMENT TAX PRORATION OF INCOME--DELETED

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JULY 1, 1979

Allowed corporations (other than Subchapter S corporations) with taxable years which began prior to January 1, 1981 or ended after December 31, 1980 to elect to prorate their income for purposes of computing their Replacement Tax liability at the appropriate rate (2.85% or 2.5%) by either using the number of days method (subsection (f)(1)) or the specific accounting method (subsections (f)(2), (f)(2)(A) or (B)).

AMENDED BY:

PUBLIC ACT 83-1352 - EFFECTIVE: SEPTEMBER 8, 1984

Substituted references to "a corporation for which there is in effect for the taxable year an election under Section 1372 of the Internal Revenue Code" with references to "a Subchapter S corporation."

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DELETED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31,1987

SECTION 201(e)--REPLACEMENT TAX INVESTMENT CREDIT

CREATED BY:

PUBLIC ACT 82-315 - EFFECTIVE: JANUARY 1, 1982

Allowed a credit against Replacement Tax for investment in qualified property.

AMENDED BY:

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Delayed the start date of the credit until July 1, 1984 and the start date of the additional credit until July 1, 1986.

Extended the termination date of the credit until December 31, 1989.

PUBLIC ACT 83-596 - EFFECTIVE: JANUARY 1, 1984

Changed when property was considered "placed in service" for computation of the credit. Also amended the manner in which the additional base employment in Illinois was computed.

Excluded property, which had been previously used in Illinois in a manner that would allow it to have been claimed for this credit or the Enterprise Zone Investment Credit.

Changed the definition of "basis."

PUBLIC ACT 84-165 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1985

Allowed taxpayers meeting certain requirements to carry any excess credit forward 5 years.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Delayed the effective date of the carryforward until December 31, 1987.

PUBLIC ACT 85-1200 - EFFECTIVE: RETROACTIVE TO JULY 1, 1986

Allowed taxpayers that are new to Illinois to qualify for the additional credit for increased base employment.

PUBLIC ACT 86-44 - EFFECTIVE: JULY 13, 1989

For tax years ending on or after December 31, 1988, the carryforward or any excess credit for 5 years is available to all taxpayers.

Extended the termination date of the credit until December 31, 1996.

PUBLIC ACT 88-141 - EFFECTIVE: JANUARY 1, 1994

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Added specific items, which are or are not considered "qualified property" for purposes of the credit. Also changed the requirement that the property had to be used in retailing, manufacturing or mining activities to be eligible for the credit to requiring that the purchaser be primarily engaged in retailing, manufacturing or mining to be able to claim the credit.

PUBLIC ACT 89-519 - EFFECTIVE JULY 18, 1996

Extends the RTIC until 12/31/2003.

PUBLIC ACT 89-591 - EFFECTIVE AUGUST 1, 1996

Extends the RTIC until 12/31/2003.

PUBLIC ACT 90-458 - EFFECTIVE: AUGUST 17, 1997

Allows partnerships to elect to flow-through any RTIC to its partners. The credit is distributed per IRC rules. The election is made on the partnership return for the year and is irrevocable.

PUBLIC ACT 91-913 - EFFECTIVE: JANUARY 1, 2001

Provides that for years ending before December 31, 2000, a partnership may elect to pass through to its partners the credits to which the partnership is entitled under subsection (e). Adds a provision for years ending on or after December 31, 2000, which provides that investment credits earned by a partnership or Subchapter S corporation and allocable to partners or shareholders who are subject to replacement tax will automatically flow through to those partners or shareholders, while the amount allocable to other partners will remain with the partnership or Subchapter S corporation.

PUBLIC ACT 93-871 - EFFECTIVE: AUGUST 6, 2004

Extends the RTIC until 12/31/2008.

PUBLIC ACT 94-1021 - EFFECTIVE: JULY 12, 2006

Allows the RTIC for property placed in service in a River Edge Redevelopment Zone.

PUBLIC ACT 96-115 - EFFECTIVE: JULY 31, 2009

Provides that electricity is not tangible personal property for purposes of the RTIC.

PUBLIC ACT 96-116 - EFFECTIVE: JULY 31, 2009

Extends the RTIC until 12/31/2013.

PUBLIC ACT 97-636 – EFFECTIVE: DECEMBER 16, 2011

Extends the RTIC until 12/31/2018.

SECTION 201(f)--INVESTMENT CREDIT--ENTERPRISE ZONE

CREATED BY:

PUBLIC ACT 82-1019 - EFFECTIVE: DECEMBER 7, 1982

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Allowed a credit against Income Tax for investments in qualified property, which was used in an Enterprise Zone. Originally enacted as Section 201(h).

AMENDED BY:

PUBLIC ACT 83-596 - EFFECTIVE: JANUARY 1, 1984

Provided that the credit could not reduce the Income Tax liability below zero.

Changed when property was considered "placed in service" for computation of the credit. Also amended the manner in which the additional base employment in Illinois was computed.

Excluded property, which had been previously used in Illinois in a manner that would allow it to have been claimed for this credit or the Replacement Tax Investment Credit.

Changed the definition of "basis."

PUBLIC ACT 84-166 - EFFECTIVE: AUGUST 16, 1985
PUBLIC ACT 84-940 - EFFECTIVE: AUGUST 16, 1985

Allowed partnerships and Subchapter S corporations to claim the credit. Also provided, for tax years ending on or after December 31, 1985, for a 5-year carryforward of any excess credit.

PUBLIC ACT 84-1400 - EFFECTIVE: SEPTEMBER 18, 1986

Corrected the amendments contained in PA 84-166 and PA 84-940 to allow a pass-through of the credit to the partners of partnerships and the shareholders of Subchapter S corporations.

PUBLIC ACT 85-741 - EFFECTIVE: SEPTEMBER 22, 1987

Recodified this credit as Section 201(f).

PUBLIC ACT 91-644 - EFFECTIVE: AUGUST 20, 1999

Adds a provision to allow owners of limited liability companies, if the company is treated as a partnership for purposes of federal and state income taxation, to claim an Enterprise Zone Investment credit to be determined in accordance with the determination of income and distributive share of income under Sections 702 and 704 of Subchapter S of the Internal Revenue Code.

PUBLIC ACT 94-1021 - EFFECTIVE: JULY 12, 2006

Allows the credit for property placed in service in a River Edge Redevelopment Zone and creates the additional credit in (f)(7) for property placed in service in a River Edge Redevelopment Zone by a taxpayer that increases its Illinois employment over the prior year.

PUBLIC ACT 101-9 EFFECTIVE: JUNE 5, 2019

Incorporates the Enterprise Zone construction jobs credit into the existing credit.

SECTION 201(g)--JOB TAX CREDIT; ENTERPRISE ZONE, FOREIGN TRADE ZONE OR SUB-ZONE

CREATED BY:

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PUBLIC ACT 84-166 - EFFECTIVE: AUGUST 16, 1985

Allowed taxpayers a credit against Income Tax for eligible employees hired to work in an Enterprise Zone on or after January 1, 1986. Any excess credit could be carried forward 5 years for tax years ending on or after December 31, 1985.

AMENDED BY:

PUBLIC ACT 84-1120 - EFFECTIVE: MAY 9, 1986

Redefined the term "eligible employee."

PUBLIC ACT 84-1124 - EFFECTIVE: JUNE 30, 1986

Extended the credit to employers designated as a High Impact Business by DCCA operating in a Foreign Trade Zone or Sub-Zone.

PUBLIC ACT 85-973 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1988

Modified the tax year for which the credit could be claimed.

PUBLIC ACT 93-871 - EFFECTIVE: AUGUST 6, 2004

Changes reference to DCCA to DCEO.

PUBLIC ACT 94-1021 - EFFECTIVE: JULY 12, 2006

Allows the credit for eligible employees in a River Edge Redevelopment Zone.

PUBLIC ACT 97-905 – EFFECTIVE: AUGUST 7, 2012

Deletes all references to enterprise zones.

REPEALED BY:

PUBLIC ACT 98-109- EFFECTIVE: JULY 25, 2013

SECTION 201(h)--INVESTMENT CREDIT--HIGH IMPACT BUSINESS

CREATED BY:

PUBLIC ACT 84-769 - EFFECTIVE: JANUARY 1, 1986

Allowed a DCCA certified High Impact Business a credit against Income Tax based on investments in qualified property placed in service in a Foreign Trade Zone. The credit was not allowed to reduce an Income Tax liability below zero.

AMENDED BY:

PUBLIC ACT 84-1440 - EFFECTIVE: JANUARY 2, 1987

Extended credit to property placed in service in a Foreign Trade Sub-Zone.

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PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Allowed any excess credit to be carried forward 5 years.

PUBLIC ACT 85-1182 - EFFECTIVE: JANUARY 1, 1989

Deleted requirement that property had to be placed in service in a Foreign Trade Zone or Sub-Zone.

PUBLIC ACT 86-803 - EFFECTIVE: SEPTEMBER 7, 1989

Provided that the credit is not available until the minimum investment is satisfied.

PUBLIC ACT 93-871 - EFFECTIVE: AUGUST 6, 2004

Changes reference to DCCA to DCEO.

SECTION 201(h-5)--HIGH IMPACT BUSINESS CONSTRUCTION JOBS CREDIT

CREATED BY:

PUBLIC ACT 101-9 - EFFECTIVE: JUNE 5,2019

Incorporates the High Impact Business construction jobs credit into the existing credit.

SECTION 201(i)--INCOME TAX CREDIT FOR REPLACEMENT TAX LIABILITY

CREATED BY:

PUBLIC ACT 84-1042 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

Allowed a credit against Income Tax based on the Replacement Tax liability. The credit was not allowed to reduce the Income Tax liability below zero. Any excess credit could be carried back 3 years and forward 15 years.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Changed the carryover provisions to state that any excess credit could be carried forward 5 years. Also changed the manner in which the credit was applied.

PUBLIC ACT 85-1290 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1989

Changed the manner in which the credit is computed.

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Added the heading “Credit for Personal Property Tax Replacement Income Tax” to the beginning of the paragraph and changed references to “subsection (a) and (b)” to “subsections (a) and (b)”.

PUBLIC ACT 93-29 - EFFECTIVE: JUNE 20, 2003

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No credit may be earned under this subsection or carried forward into a tax year ending on or after December 31, 2003.

SECTION 201(j)--TRAINING EXPENSE CREDIT

CREATED BY:

PUBLIC ACT 84-1405 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

Allowed a credit against Income Tax for job training expenses for Illinois employees and Illinois residents. The credit cannot reduce the Income Tax liability below zero. Any excess credit can be carried forward 5 years.

AMENDED BY:

PUBLIC ACT 91-644 - EFFECTIVE: AUGUST 20, 1999

Adds a provision to allow owners of limited liability companies, if the company is treated as a partnership for purposes of federal and state income taxation, to claim a Training Expense credit to be determined in accordance with the determination of income and distributive share of income under Sections 702 and 704 of Subchapter S of the Internal Revenue Code.

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Makes a wording change from “subsection” to “subsections”.

PUBLIC ACT 93-29 - EFFECTIVE: JUNE 20, 2003

No credit may be earned under this subsection or carried forward into a tax year ending on or after December 31, 2003.

SECTION 201(k)--RESEARCH AND DEVELOPMENT CREDIT

CREATED BY:

PUBLIC ACT 86-988 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JULY 1, 1990

Allowed a credit against Income Tax for increasing research activities in Illinois. The credit is equal to 6.5% of the qualifying expenditures for increasing research activities in Illinois. The term "qualifying expenditures" has the same meaning for purposes of this credit as the term does for federal credit purposes as allowed under Section 41 of the IRC but, in addition, the qualifying expenditures must be applicable to research activities which are conducted in Illinois. Any excess credit can be carried forward 5 years. Unless extended by law, the credit does not include expenses incurred after December 31, 1994.

AMENDED BY:

PUBLIC ACT 88-89 - EFFECTIVE: JULY 1, 1993

Eliminates the refund provisions of the credit. Any credit in excess of the tax liability for the year may be carried forward up to 5 years to offset future tax liabilities.

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This same amendment was also made by Public Act 88-45.

PUBLIC ACT 88-547 - EFFECTIVE: JUNE 30, 1994

Extends the Research and Development Credit to include costs incurred on or before December 31, 1999. Also eliminated the requirement that the Department would evaluate the usefulness of the credit and report its findings to the General Assembly.

PUBLIC ACT 90-605 - EFFECTIVE: JUNE 30, 1998

Unless extended by law, the credit shall not include costs incurred after December 31, 2004, except for costs incurred pursuant to a binding contract entered into on or before December 31, 2004.

PUBLIC ACT 91-644 - EFFECTIVE: AUGUST 20, 1999

Adds a provision to allow partners, shareholders of subchapter S corporations, and owners of limited liability companies, if the company is treated as a partnership for purposes of federal and state income taxation, to claim a Research and Development credit to be determined in accordance with the determination of income and distributive share of income under Sections 702 and 704 of Subchapter S of the Internal Revenue Code.

No inference can be drawn from this amendatory Act in construing this section for taxable years beginning before January 1, 1999.

PUBLIC ACT 93-29 - EFFECTIVE: JUNE 20, 2003

No credit may be earned under this subsection or carried forward into a tax year ending on or after December 31, 2003.

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Reenacts the credit for taxable years ending on or after December 31, 2004, while prohibiting carryovers of credits earned prior to the repeal to subsequent years.

PUBLIC ACT 96-0937- EFFECTIVE: JUNE 23, 2010

No credit may be earned under this subsection or carried forward into a tax year ending after December 31, 2010.

PUBLIC ACT 97-636- EFFECTIVE: DECEMBER 16, 2011

Extends the credit through taxable years ending prior to January 1, 2016, and deletes the prohibition against carrying credits forward past December 31, 2010.

PUBLIC ACT 100-22 – EFFECTIVE: JULY 6, 2017

Extends the credit through taxable years ending prior to January 1, 2022, and adds language stating that the legislative intent is to treat the credit as not expiring after January 1, 2016.

PUBLIC ACT 101-207 – EFFECTIVE: AUGUST 23, 2019

Extends the credit through taxable years ending prior to January 1, 2027.

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SECTION 201(l)--ENVIRONMENTAL REMEDIATION TAX CREDIT

CREATED BY:

PUBLIC ACT 90-123 - EFFECTIVE: TAX YEARS ENDING AFTER 12/31/97 AND ON OR BEFORE 12/31/2001

Creates a new income tax credit equal to 25% of unreimbursed eligible remediation costs in excess of $100,000 per site, except that the $100,000 threshold does not apply to sites contained in an enterprise zone and located in a census tract that is located in a minor civil division and place or county which has been determined by DCCA to contain a majority of households consisting of low and moderate income persons. The total credit allowed per year is $40,000 and the total per site is $150,000.

Eligible remediation costs will be determined by EPA and can be claimed in the year that a No Further Remediation letter is received from EPA. Costs may not be deducted in the computation of federal AGI or taxable income.

Persons who are responsible for the contamination of the site or who are related to the responsible parties (under Section 267 of the IRC) are not eligible.

The credit may be sold with the property associated with the credit. Excess credit may be carried forward for 5 years.

AMENDED BY:

PUBLIC ACT 90-717 - EFFECTIVE: AUGUST 7, 1998

Removed the provisions that did not allow costs which were deducted federally from being included as eligible remediation costs.

PUBLIC ACT 90-792 - EFFECTIVE: JANUARY 1, 1999

Changes the requirement of the exemption of the $100,000 threshold to state that any eligible site located in an enterprise zone will apply.

PUBLIC ACT 93-871 - EFFECTIVE: AUGUST 6, 2004

Changes reference to DCCA to DCEO.

SECTION 201(m)--EDUCATION EXPENSE CREDIT

CREATED BY:

PUBLIC ACT 91-009 - EFFECTIVE: FOR TAX YEARS ENDING AFTER DECEMBER 31, 1999

Creates the Education Expense credit for individuals. The credit is equal to 25% of the “qualified education expenses” incurred by a family. “Qualified education expenses” are defined as costs in excess of $250 for tuition, book fees, and lab fees at the school in which the pupil is enrolled. To qualify for the credit, a pupil must be a resident of Illinois, under 21 years of age, and a full-time pupil enrolled in a Kindergarten through grade 12 education program at any public or nonpublic elementary or secondary school in Illinois.

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The credit cannot exceed $500 per family. The credit cannot reduce the taxpayer's liability below zero, which means any credit exceeding a taxpayer's liability is not refundable. Further, any excess credit cannot be carried back or forward.

AMENDED BY:

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Makes a wording change from "this section" to "this subsection"

PUBLIC ACT 100-22 – EFFECTIVE: JULY 6, 2017

Increases the maximum credit to $750 for tax years ending on or after December 31, 2017. Provides that no credit is allowed for any tax year beginning on or after January 1, 2017, to taxpayers with adjusted gross income in excess of $500,000 if married filing joint for federal income tax purposes or $250,000 for all other taxpayers.

SECTION 201(n)--RIVER EDGE REDEVELOPMENT ZONE REMEDIATION TAX CREDIT

CREATED BY:

PUBLIC ACT 94-1021 - EFFECTIVE: JULY 12, 2006

Creates a new income tax credit equal to 25% of unreimbursed eligible remediation costs in excess of $100,000 per site incurred to clean up sites within River Edge Redevelopment Zones.

AMENDED BY:

PUBLIC ACT 95-454 - EFFECTIVE: AUGUST 27, 2007

Corrects the reference to Section 58.14a of the Environmental Protection Act.

PUBLIC ACT 97-0002- EFFECTIVE: MAY 6, 2011

Repealed the exemption from automatic sunset under Section 250.

SECTION 201(o)—COMPASSIONATE USE OF MEDICAL CANNABIS SURCHARGE

CREATED BY:

PUBLIC ACT 98-122 - EFFECTIVE: AUGUST 1, 2013

Imposes a surcharge on gains realized on capital assets and assets used in business by licensees under the Compassionate Use of Medical Cannabis Pilot Program, equal to the federal income tax on the gains.

AMENDED BY:

PUBLIC ACT 101-363 - EFFECTIVE: AUGUST 9, 2019

Deletes "Pilot" from references to the Compassionate Use of Medical Cannabis Program Act

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SECTION 201.5--STATE SPENDING LIMITATION AND TAX REDUCTION

CREATED BY:

PUBLIC ACT 96-1496- EFFECTIVE: JANUARY 13, 2011

Imposes limitations on general revenue state expenditures through FY 2015, and provides that, if the limitations are exceeded, the tax rates imposed under this act are repealed, so that rates revert to 3% for individuals, trusts and estates, and 4.8% for corporations.

AMENDED BY:
PUBLIC ACT 97-0813 – EFFECTIVE: JULY 13, 2012

Corrects a spelling error.

SECTION 202--NET INCOME DEFINED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 83-402 - EFFECTIVE: JANUARY 1, 1984

Added: The statement, "except money and other benefits, other than salary, received by a driver in a ridesharing arrangement using a motor vehicle..."

PUBLIC ACT 84-1042 - EFFECTIVE: FOR TAX YEARS ENDING DECEMBER 31, 1986

Added: A provision for the subtraction of the deduction allowed by Section 207 (in addition to the standard exemption allowed by Section 204) in the computation of net income.

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Deleted the statement, “except money and other benefits, other than salary, received by a driver in a Ridesharing arrangement using a motor vehicle”. This provision was moved to Section 203(a)(2)(Z), which was later recodified as Section 203(a)(2)(BB).

SECTION 202(b)--INCOME TAX INCOME PRORATION--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Allowed taxpayers to elect to prorate income earned in a taxable year which began prior to August 1, 1969 and ended after July 31, 1969 by either the number of days method (subsection (b)(1)) or specific accounting (subsection (b)(2)).

DELETED BY:

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PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

SECTION 202.1--NET INCOME DURING TAX RATE INCREASE--DELETED

CREATED BY:

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Allowed taxpayers to use either the number of day's method (subsection (a)) or the specific accounting method (subsection (b)) when computing the net income attributable to the period during which the tax rate was increased if the taxable year began before January 1, 1983 or ended after December 31, 1982.

DELETED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

SECTION 202.2--NET INCOME DURING TAX RATE INCREASE--DELETED

CREATED BY:

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Allowed taxpayers to use either the number of day's method (subsection (a)) or the specific accounting method (subsection (b)) when computing the net income attributable to the period during which the tax rate was increased if the taxable year began before July 1, 1984 or ended after June 30, 1984.

DELETED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

SECTION 202.3--NET INCOME DURING TAX RATE INCREASE

CREATED BY:

PUBLIC ACT 86-18 - EFFECTIVE: JULY 5, 1989

Allows taxpayers to use either the number of day's method (subsection (a)) or the specific accounting method (subsection (b)) when computing the net income attributable to the period during which the tax rate was increased if the taxable year began before July 1, 1989 or ended after June 30, 1989.

AMENDED BY:

No amendments.

SECTION 202.4--NET INCOME DURING TAX RATE INCREASE--DELETED

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CREATED BY:

PUBLIC ACT 86-18 - EFFECTIVE: JULY 5, 1989

Allows taxpayers to use either the number of days method (subsection (a)) or the specific accounting method (subsection (b)) when computing the net income attributable to the period during which the tax rate is increased if the taxable year begins before July 1, 1991 or ended after June 30, 1991.

AMENDED BY:

PUBLIC ACT 87-17 - EFFECTIVE: RETROACTIVE TO JULY 1, 1991

Extends the specific accounting period to agree with the extended rate increase period.

DELETED BY:

PUBLIC ACT 88-89 - EFFECTIVE: JULY 1, 1993

SECTION 202.5--NET INCOME ATTRIBUTABLE TO YEARS IN WHICH RATES CHANGE

CREATED BY:

PUBLIC ACT 96-1496- EFFECTIVE: JANUARY 13, 2011

Provides for election to pro-rate income or use separate accounting to determine income attributable to portions of tax year before and after a rate change.

AMENDED BY:

PUBLIC ACT 100-22 – EFFECTIVE: JULY 6, 2017

Amended the section to provide for tax rate changes an any date during the year, rather than only on January 1, and to expressly provide for treatment of exemptions and for years in which income is negative in the period to which one tax rate applies and positive in the other,

SECTION 203--BASE INCOME DEFINED

SECTION 203(a)(1)--INDIVIDUALS--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments.

SECTION 203(a)(2)--INDIVIDUALS--MODIFICATIONS

CREATED BY:

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PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

See Section 203(a)(2)(N) below.

ADDITION MODIFICATIONS

SECTION 203(a)(2)(A)--FEDERALLY EXEMPT INTEREST/DIVIDENDS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Required an addition modification for federally exempt interest and dividends not included in AGI.

AMENDED BY:

PUBLIC ACT 83-806 - EFFECTIVE: JANUARY 1, 1984

Added: A provision that excludes stock dividends of qualified public utilities from the addition modification.

SECTION 203(a)(2)(B)--CAPITAL GAIN ADDITION--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Required an addition modification for 50% of the excess net long-term capital gain over the net short-term capital loss, to the extent excluded from AGI.

AMENDED BY:

PUBLIC ACT 81-444 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1979

Substituted reference to IRC Section 1202 for 50% of the excess of the net long-term capital gain.

DELETED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

SECTION 203(a)(2)(B)--INCOME TAX DEDUCTED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Required an addition modification for the amount of Income Tax excluded in the computation of AGI.

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AMENDED BY:

No amendments.

SECTION 203(a)(2)(C)-- PROPERTY TAX REFUNDS

CREATED BY:

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Requires the addition of any refund of real property tax on the taxpayer's principal residence, to the extent the taxpayer claimed a subtraction for the tax under former Section 203(a)(2)(L).

AMENDED BY:

No amendments.

SECTION 203(a)(2)(D)--CAPITAL GAIN ADDITION

CREATED BY:

PUBLIC ACT 86-678 - EFFECTIVE: SEPTEMBER 1, 1989

An amount equal to the capital gain deduction allowable under the IRC should be added back.

AMENDED BY:

No amendments.

SECTION 203(a)(2)(D-5)--MEDICAL CARE SAVINGS ACCOUNT ADDITION

CREATED BY:

PUBLIC ACT 88-648 - EFFECTIVE: TAX YEARS BEGINNING AFTER DECEMBER 31, 1993

An amount, to the extent not included in AGI, equal to the amount of money withdrawn by the taxpayer in the taxable year from a medical care savings account and the interest earned on the account in the taxable year of a withdrawal pursuant to Section 20(b) of the Medical Care Savings Account Act should be added back.

AMENDED BY:

PUBLIC ACT 91-845 - EFFECTIVE: JUNE 22, 2000

Adds a reference to the Medical Care Savings Account Act of 2000.

DELETED BY:

PUBLIC ACT 91-845 – EFFECTIVE: JUNE 22, 2000

This section is repealed on January 1, 2010.

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SECTION 203(a)(2)(D-10)--ELIGIBLE REMEDIATION COSTS ADDITION

CREATED BY:

PUBLIC ACT 90-717 - EFFECTIVE: AUGUST 7, 1998

Requires an addition of any eligible remediation costs deducted in computing adjusted gross income for which the individual claims the Environmental Remediation Credit.

SECTION 203(a)(2)(D-15)--BONUS DEPRECIATION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

For taxable years 2001 and after, an addition for the amount equal to the bonus depreciation deduction taken on the taxpayer's federal income tax return under subsection (k) of Section 168 of the Internal Revenue Code.

AMENDED BY:

PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

Requires add-back of bonus depreciation subtractions related to an asset that is sold, abandoned or disposed of in any manner during the tax year, or whose depreciable life terminates during the tax year.

SECTION 203(a)(2)(D-16)--BONUS DEPRECIATION DEDUCTION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

Requires an addition for an amount equal to the aggregate amount of the deductions taken in all taxable years under subparagraph (Z) with respect to that property.

SECTION 203(a)(2)(D-17)--INTEREST EXPENSE DISALLOWANCE

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, disallows the deduction of interest expense incurred in a transaction with a person that would be a member of the same unitary business group as the taxpayer if not for the 80-20 test.

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AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Expands the deduction disallowance beginning with taxable years ending December 31, 2008, to apply to payments to a person who would be a member of the same unitary group as the taxpayer if not for the noncombination rule.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Made technical corrections to the amendments in Public Act 95-233.

SECTION 203(a)(2)(D-18)--INTANGIBLES EXPENSE DISALLOWANCE

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, disallows the deduction of certain intangible expenses incurred in a transaction with a person that would be a member of the same unitary business group as the taxpayer if not for the 80-20 test.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Expands the deduction disallowance beginning with taxable years ending December 31, 2008, to apply to payments to a person who would be a member of the same unitary group as the taxpayer if not for the noncombination rule.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Made technical corrections to the amendments in Public Act 95-233.

SECTION 203(a)(2)(D-19)--INSURANCE PREMIUM EXPENSE DISALLOWANCE

CREATED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Beginning with taxable years ending on or after December 31, 2008, disallows the deduction of insurance premiums paid to a person who would be a member of the same unitary group as the taxpayer if not for the noncombination rule.

AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Made technical corrections to the amendments in Public Act 95-233.

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SECTION 203(a)(2)(D-20)--COLLEGE SAVINGS POOL

CREATED BY:

PUBLIC ACT 92-626 - EFFECTIVE: JULY 11, 2002

Added new subsection (D-15) to require the add-back of distributions from college savings plans excluded from federal adjusted gross income under IRC Section 529 other than (i) other than distributions from College Savings Pool and the Illinois Prepaid Tuition Program and (ii) distributions excluded from tax because they were rolled over into other college savings plans.

AMENDED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Renumbered as (D-20).

PUBLIC ACT 95-23 - EFFECTIVE: AUGUST 3, 2007

For taxable years beginning on or after January 1, 2007, does not require the add-back of distributions from non-Illinois Section 529 plans that disclose to Illinois residents that Illinois has its own plans.

SECTION 203(a)(2)(D-20.5)—ABLE ACCOUNT DISTRIBUTIONS

CREATED BY:

PUBLIC ACT 100-905 - EFFECTIVE: AUGUST 17, 2018

Added new subsection (D-20.5) to require the add-back of federally exempt distributions from a non-Illinois ABLE account in tax years beginning on or after January 1, 2018.

SECTION 203(a)(2)(D-21)--RECAPTURE OF SECTION 529 PLAN CONTRIBUTIONS

CREATED BY:

PUBLIC ACT 95-23 - EFFECTIVE: AUGUST 3, 2007

For tax years beginning on or after January 1, 2007, requires taxpayers to add back subtractions previously taken for contributions to Illinois Section 529 plans when amounts are removed from the Illinois plan and rolled over into a non-Illinois plan.

SECTION 203(a)(2)(D-21.5)—TRANSFERS FROM ILLINOIS 529 PLANS AND ABLE ACCOUNTS TO NON-ILLINOIS ABLE ACCOUNTS

CREATED BY:

PUBLIC ACT 100-905 - EFFECTIVE: AUGUST 17, 2018

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Added new subsection (D-21.5) to require the add-back of deductions previous allowed under (Y) or (HH) for contributions to Illinois 529 plans and ABLE accounts for distributions made from an Illinois 529 plan or ABLE account to a non-Illinois ABLE account in tax years beginning on or after January 1, 2018.

SECTION 203(a)(2)(D-22)--RECAPTURE OF SECTION 529 PLAN CONTRIBUTIONS

CREATED BY:

PUBLIC ACT 96-120 - EFFECTIVE: AUGUST 4, 2009

For tax years beginning on or after January 1, 2009, requires taxpayers to add back subtractions previously taken for contributions to Illinois Section 529 plans when amounts are removed from the Illinois plan and spent for non-qualifying purposes.

AMENDED BY:

PUBLIC ACT 100-905 - EFFECTIVE: AUGUST 17, 2018

For tax years beginning on or after January 1, 2018, taxpayers are also required to add back subtractions previously taken for contributions to an Illinois ABLE account when amounts are removed from the account for non-qualifying purposes.

SECTION 203(a)(2)(D-23)--EMPLOYER CONTRIBUTIONS TO SECTION 529 PLANS

CREATED BY:

PUBLIC ACT 96-198 - EFFECTIVE: AUGUST 10, 2009

Requires an add-back equal to the credit allowed under Section 218 for employer contributions to Section 529 plans.

AMENDED BY:

PUBLIC ACT 96-835 - EFFECTIVE: AUGUST 10, 2009

Renumbered this provision from (D-22) to (D-23).

SECTION 203(a)(2)(D-24)—DOMESTIC PRODUCTION ACTIVITIES DEDUCTION

CREATED BY:

PUBLIC ACT 100-22 – EFFECTIVE: JULY 6, 2017

Requires the add-back of any domestic production activities deduction allowed under IRC Section 199 in taxable years ending on or after December 31, 2017.

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SUBTRACTION MODIFICATIONS

SECTION 203(a)(2)(E)--MILITARY PAY

CREATED BY:

PUBLIC ACT 76-2029 - EFFECTIVE: JUNE 19, 1970

Allowed a subtraction for compensation for military duties paid to a resident in 1970 or thereafter.

AMENDED BY:

PUBLIC ACT 77-610 - EFFECTIVE: AUGUST 2, 1971

Incorporated a reference to National Guard pay.

PUBLIC ACT 78-294 - EFFECTIVE: AUGUST 13, 1973

Added a reference to pay received by a serviceman or government employee while a POW or MIA.

PUBLIC ACT 92-244 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 2001

Allows the subtraction for pay earned in the United States military or in the Illinois National Guard.

PUBLIC ACT 95-286 - EFFECTIVE: AUGUST 20, 2007

For tax years ending on or after December 31, 2007, pay from other states' National Guards may be subtracted.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Amended the exception from automatic sunset under Section 250 to apply to the entire subparagraph.

SECTION 203(a)(2)(F)--RETIREMENT PAY

CREATED BY:

PUBLIC ACT 77-669 - EFFECTIVE: FOR TAX YEARS BEGINNING AFTER DECEMBER 31, 1970

Allowed a subtraction for payments from certain retirement plans.

AMENDED BY:

PUBLIC ACT 77-2062 - EFFECTIVE: FOR TAX YEARS BEGINNING AFTER DECEMBER 31, 1971

Added the statement, "...or included in such total as distributions under the provisions of any retirement or disability plan for employees of any governmental agency or unit..." and to delete the provision limiting the subtraction to amounts accrued prior to August 1, 1969.

PUBLIC ACT 79-1426 - EFFECTIVE: TAX YEARS ENDING AFTER DECEMBER 31, 1976

Added the references to IRC Sections 408 and 409.

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PUBLIC ACT 83-1498 - EFFECTIVE: DECEMBER 27, 1984
PUBLIC ACT 83-1500 - EFFECTIVE: DECEMBER 27, 1984

Added the statement, "...or retirement payments to retired partners..."

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987.

Deleted references to repealed sections of the IRC for payments from employee benefit, retirement plans and social security.

SECTION 203(a)(2)(G)--VALUATION LIMITATION AMOUNT

CREATED BY:

PUBLIC ACT 77-669 - EFFECTIVE: FOR TAX YEARS BEGINNING AFTER DECEMBER 31, 1970

Allowed a subtraction for the valuation limitation amount described in Section 203(f).

AMENDED BY:

No amendments.

SECTION 203(a)(2)(H)--ILLINOIS INCOME TAX REFUND

PUBLIC ACT 77-627 - EFFECTIVE: AUGUST 4, 1971

Allowed a subtraction for the amount of Illinois income tax refund included in AGI for the taxable year.

AMENDED BY:

No amendments.

SECTION 203(a)(2)(I)--INTERNAL REVENUE CODE SECTION 111 RECOVERY

CREATED BY:

PUBLIC ACT 79-1432 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1976

Allowed a subtraction for any amounts included in AGI under Section 111 of the IRC as a recovery of an amount previously deducted from AGI in the computation of taxable income (itemized expenses such as bad debts, medical expenses, taxes, losses, etc.).

AMENDED BY:

No amendments.

SECTION 203(a)(2)(J)--ENTERPRISE ZONE DIVIDENDS

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CREATED BY:

PUBLIC ACT 82-1019 - EFFECTIVE: DECEMBER 7, 1982

Allowed a subtraction for dividends received from corporations operating exclusively in an Enterprise Zone or zones.

AMENDED BY:

PUBLIC ACT 83-1114 - EFFECTIVE: JUNE 8, 1984

Changed requirement that the corporation operate exclusively in the Enterprise Zone or zones to "conducts substantially all of its operations" in the Zone or zones.

PUBLIC ACT 94-1021 - EFFECTIVE: JULY 12, 2006

Allows the subtraction for corporations conducting operations in a River Edge Redevelopment Zone. Exempts the subtraction from Section 250.

PUBLIC ACT 97-905 – EFFECTIVE: AUGUST 7, 2012

Deleted all references to enterprise zones.

SECTION 203(a)(2)(K)--FOREIGN TRADE ZONE/SUB-ZONE DIVIDENDS

CREATED BY:

PUBLIC ACT 84-769 - EFFECTIVE: JANUARY 1, 1986

Allowed a subtraction for dividends received from corporations designated as High Impact Businesses located in a Foreign Trade Zone or zones, if the dividend is not eligible to be deducted under Section 203(a)(2)(I).

AMENDED BY:

PUBLIC ACT 84-1440 - EFFECTIVE: JANUARY 2, 1987

Expanded the modification to businesses designated as High Impact Businesses and located in a Foreign Trade Sub-Zone.

SECTION 203(a)(2)(L)--PROPERTY TAXES PAID--DELETED

CREATED BY:

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Allowed a subtraction for the amount of real property taxes imposed and paid.

AMENDED BY:

PUBLIC ACT 86-18 - EFFECTIVE: FOR TAX YEARS ENDING IN 1989 AND 1990

The deduction shall be double the amount of real property taxes imposed and paid during each such taxable year under the Revenue Act of 1939 on the taxpayer's principal residence.

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DELETED BY:

PUBLIC ACT 87-17 - EFFECTIVE: RETROACTIVE TO JULY 1, 1991

SECTION 203(a)(2)(L)--SOCIAL SECURITY/RAILROAD RETIREMENT BENEFITS

CREATED BY:

PUBLIC ACT 83-1498 - EFFECTIVE: DECEMBER 27, 1984

Allowed a subtraction for social security benefits and railroad retirement benefits included in AGI.

AMENDED BY:

No amendments.

SECTION 203(a)(2)(M)--PRAIRIE STATE 2000 FUND—DELETED

CREATED BY:

PUBLIC ACT 83-650 - EFFECTIVE: SEPTEMBER 23, 1983

Allowed a subtraction for premiums paid to the Prairie State 2000 Fund.

DELETED BY:

PUBLIC ACT 84-1090 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

Also deleted by Public Act 84-1042 effective for tax years ending on or after December 31, 1986.

SECTION 203(a)(2)(M)--FEDERALLY DISALLOWED EXPENSES/INTEREST

CREATED BY:

PUBLIC ACT 83-561 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER SEPTEMBER 17, 1983

Allowed a subtraction for expenses relating to federally tax-exempt obligations.

AMENDED BY:

PUBLIC ACT 89-460 - DECLARATORY OF EXISTING LAW

Any expenses subtracted under Section 203(a)(2)(N) cannot also be deducted under this section.

PUBLIC ACT 91-541 – EFFECTIVE FOR TAX YEARS ENDING ON OR AFTER AUGUST 13, 1999

With the exception of the amounts subtracted under subsection N, this amendment provides a subtraction modification equal to the sum of the amounts disallowed as deductions by Sections

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171(a)(2), 265, 280C, and 832(b)(5)(B)(i) of the Internal Revenue Code; the provisions of this subparagraph are exempt from the provisions of Section 250.

PUBLIC ACT 91-845 - EFFECTIVE: JUNE 22, 2000

Added the effective date of Public Act 91-541.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Deleted extraneous language in reference to the IRC, and added subtractions for IRC Sections 45G and 87.

PUBLIC ACT 101-9- EFFECTIVE: JUNE 5, 2019 AND PUBLIC ACT 101-81 – EFFECTIVE: JULY 12, 2019

Corrects references to IRC Section 265.

SECTION 203(a)(2)(N)--EMPLOYEE TRAINING EXPENSES--DELETED

CREATED BY:

PUBLIC ACT 83-650 - EFFECTIVE: SEPTEMBER 23, 1983

Allowed a subtraction for training expenses for employees in semi-technical or technical or semi-skilled or skilled fields except for any amounts paid as premiums to the Prairie State 2000 Fund.

AMENDED BY:

PUBLIC ACT 84-1090 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

This Public Act deleted all references to the Prairie State 2000 Fund. The references were also deleted by Public Act 84-1042 effective for tax years ending on or after December 31, 1986.

DELETED BY:

PUBLIC ACT 84-1405 - EFFECTIVE: JANUARY 1, 1987

SECTION 203(a)(2)(N)--INCOME EXEMPT FROM TAX UNDER OTHER LAWS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Allowed a subtraction for income that is exempt from state taxation by virtue of Illinois', constitution and/or statutes or the United States constitution, treaties and/or statutes. (This was the only subtraction allowed in the original IITA.)

AMENDED BY:

PUBLIC ACT 89-460 - DECLARATORY OF EXISTING LAW

The amount of the interest income subtracted must be net of bond premium amortization.

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PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

For taxable years ending on or after December 31, 2008, requires the add-back of expenses incurred to carry tax-exempt bonds.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Repeals the provisions of Public Act 95-233 requiring the add-back of expenses incurred to carry tax-exempt bonds.

SECTION 203(a)(2)(O)--TRAINING EXPENSES--DELETED

CREATED BY:

PUBLIC ACT 83-650 - EFFECTIVE: SEPTEMBER 23, 1983

Allowed a subtraction for training expenses from courses, which are qualified under the Prairie State 2000 Fund.

DELETED BY:

PUBLIC ACT 84-1090 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

Also deleted by Public Act 84-1042, which was effective for tax years ending on or after December 31, 1986.

SECTION 203(a)(2)(O)--JOB TRAINING PROJECT CONTRIBUTION

CREATED BY:

PUBLIC ACT 84-1090 - EFFECTIVE: JANUARY 1, 1986

Allowed a subtraction for contributions to a training project established pursuant to the "Real Property Tax Increment Allocation Redevelopment Act."

AMENDED BY:

No amendments.

SECTION 203(a)(2)(P)--CLAIM OF RIGHT

CREATED BY:

PUBLIC ACT 85-731 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Allowed a subtraction for restoration of substantial amounts held under claim of right to the extent deducted from AGI.

AMENDED BY:

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PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Amended to allow subtraction when an itemized deduction is claimed for repayment of claim of right income.

SECTION 203(a)(2)(Q)--INSURANCE BENEFITS

CREATED BY:

PUBLIC ACT 87-119 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1991

Created a subtraction for amounts received and included in AGI as an acceleration in the payment of life, endowment or annuity benefits in advance of the time they would otherwise be payable as an indemnity for a terminal illness.

AMENDED BY:

No amendments.

SECTION 203(a)(2)(R)--CONTRIBUTIONS TO COMMUNITY BASED ORGANIZATIONS--DELETED

CREATED BY:

PUBLIC ACT 84-997 - EFFECTIVE: JANUARY 1, 1986

Allowed a subtraction for contributions made to community-based organizations.

AMENDED BY:

PUBLIC ACT 84-1308 - EFFECTIVE: AUGUST 25, 1986

Added the statement, "...to assist local government programs in gang control..."

DELETED BY:

PUBLIC ACT 84-1400 - EFFECTIVE: DECEMBER 31, 1986

The deletion did not take into account the amendment of Public Act 84-1308. Therefore, the statement "...to assist local government programs in gang control..." was subsequently deleted by Public Act 85-731.

SECTION 203(a)(2)(R)--VETERAN'S BONUS

CREATED BY:

PUBLIC ACT 87-343 - EFFECTIVE: JANUARY 1, 1992

Creates a subtraction equal to the amount of any federal or State bonus paid to veterans of the Persian Gulf War.

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AMENDED BY:

No amendments.

SECTION 203(a)(2)(S)--MEDICAL CARE SAVINGS ACCOUNT

CREATED BY:

PUBLIC ACT 88-648 - EFFECTIVE: TAX YEARS BEGINNING AFTER DECEMBER 31, 1993

Creates a subtraction for an amount, to the extent included in AGI, equal to the amount of a contribution made in the taxable year on behalf of the taxpayer to a medical care savings account to the extent the contribution is accepted by the account administrator.

AMENDED BY:

PUBLIC ACT 91-845 - EFFECTIVE: JUNE 22, 2000

Adds a reference to the Medical Care Savings Account Act of 2000.

DELETED BY:

PUBLIC ACT 91-845 – EFFECTIVE: JUNE 22, 2000

This section is repealed on January 1, 2010.

SECTION 203(a)(2)(T)--MEDICAL CARE SAVINGS ACCT INTEREST

CREATED BY:

PUBLIC ACT 88-648 - EFFECTIVE: TAX YEARS BEGINNING AFTER DECEMBER 31, 1993

Creates a subtraction for an amount, to the extent included in AGI, equal to the amount of interest earned in the taxable year on a medical care savings account, other than interest added pursuant to the addition modification contained in Section 203(a)(2)(D-5).

AMENDED BY:

PUBLIC ACT 91-845 - EFFECTIVE: JUNE 22, 2000

Adds a reference to the Medical Care Savings Account Act of 2000.

DELETED BY:

PUBLIC ACT 91-845 – EFFECTIVE: JUNE 22, 2000

This section is repealed on January 1, 2010.

SECTION 203(a)(2)(U)--NURSING HOME GRANT ASSISTANCE

CREATED BY:

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PUBLIC ACT 88-669 - EFFECTIVE: ONE TAXABLE YEAR BEGINNING ON OR AFTER JANUARY 1, 1994

Creates a subtraction equal to the total amount of income tax imposed and paid on grant amounts received by the taxpayer under the Nursing Home Grant Assistance Act during the taxpayer's taxable years 1992 and 1993. The subtraction is only allowed for one taxable year.

This subtraction was numbered Section 203(a)(2)(S) in PA 88-669. A correction will be made to the numbering when the Illinois Compiled Statutes are updated.

AMENDED BY:

No Amendments

SECTION 203(a)(2)(V)--INSURANCE SUBTRACTION MODIFICATION

CREATED BY:

PUBLIC ACT 89-418 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1995 AND ENDING ON OR BEFORE DECEMBER 31, 1999.

Allows self-employed individuals, partners in a partnership and shareholders in a subchapter S corporation, a subtraction modification for amounts paid for health insurance or long term care insurance for the taxpayer or the taxpayer's spouse or dependents. The subtraction is not allowed if the taxpayer is eligible to participate in any health insurance or long-term care insurance plan of an employer of the taxpayer or the taxpayer's spouse.

AMENDED BY:

PUBLIC ACT 91-192 - EFFECTIVE: JULY 20, 1999

Extends to taxable year 2004 for individuals the expiration date of the deduction for health insurance or long-term care insurance for that taxpayer or that taxpayer’s spouse or dependents paid by a self-employed taxpayer, partner of a partnership, or shareholder of a Subchapter S corporation.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Deleted extraneous language in reference to the IRC.

SECTION 203(a)(2)(W)--ROTH IRA SUBTRACTION MODIFICATION

CREATED BY:

PUBLIC ACT 90-770 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1998

Allow a subtraction modification for all amounts included in the taxpayer's federal gross income converted from a regular IRA to a Roth IRA.

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SECTION 203(a)(2)(X)--NAZI PERSECUTION SUBTRACTION MODIFICATION

CREATED BY:

PUBLIC ACT 91-676 - EFFECTIVE: FOR TAXABLE YEAR 1999

Creates a subtraction modification equal to the amount of distributions and items of income received by the taxpayer because of his or her status as a victim or descendant of a victim of Nazi persecution.

AMENDED BY:

No Amendments.

SECTION 203(a)(2)(Y)--COLLEGE SAVINGS POOL SUBTRACTION

CREATED BY:

PUBLIC ACT 92-439 - EFFECTIVE: TAXABLE YEARS BEGINNING ON OR AFTER JANUARY 1, 2002

Creates a subtraction modification for moneys contributed to a College Savings Pool account under Section 16.5 of the State Treasurer Act.

AMENDED BY:

PUBLIC ACT 92-626 - EFFECTIVE: JULY 11, 2002

Amended the subsection to provide that amounts excluded from gross income under Section 529(c)(3)(i) of the Internal Revenue Code shall not be subtractable contributions.

PUBLIC ACT 93-812 - EFFECTIVE: JULY 26, 2004

Amended the subsection to limit the subtraction to $10,000 per taxpayer and to allow the subtraction for contributions to the Illinois Prepaid Tuition Fund.

PUBLIC ACT 96-198 - EFFECTIVE: AUGUST 10, 2009

Provides that employer contributions qualifying for the credit under Section 218 are treated as employee contributions for purposes of this subtraction.

SECTION 203(a)(2)(Z)--DEPRECIATION DEDUCTION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

For taxable years 2001 and after, an amount equal to 42.9% of the amount of the federal depreciation deduction taken for the taxable year on property for which the bonus depreciation deduction was taken, but not including the bonus depreciation deduction.

AMENDED BY:

PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

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For tax years ending after December 31, 2005, allows the subtraction of 100% of the federal depreciation deduction of an asset on which 50% bonus depreciation was claimed. Exempts the subtraction from Section 250.

SECTION 203(a)(2)(AA)--BONUS DEPRECIATION DEDUCTION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

An amount equal to the addition modification under subparagraph (D-15) if a taxpayer reports a capital gain or loss based on a sale or transfer of property for which the taxpayer was required to make an addition modification under subparagraph (D-15).

AMENDED BY:

PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

Allows the subtraction of bonus depreciation additions related to an asset that is sold, abandoned or disposed of in any manner during the tax year, or whose depreciable life terminates during the tax year. Exempts the subtraction from Section 250.

SECTION 203(a)(2)(BB)--RIDESHARING ARRANGEMENT

CREATED BY:

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Adds subsection (Z) to move the exclusion for amounts included in adjusted gross income other than salary, received by a driver in a ridesharing arrangement using a motor vehicle from Section 202.

AMENDED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Renumbered as (BB).

SECTION 203(a)(2)(CC)--INTEREST INCOME SUBTRACTION

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For years ending on or after December 31, 2004, excludes from base income of the taxpayer any interest income whose deduction was disallowed to the payor under the 80-20 interest expense disallowance provisions.

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AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Exempted this subparagraph from automatic sunset under Section 250.

SECTION 203(a)(2)(DD)--SUBTRACTION FOR INTEREST FROM AFFILIATE

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, excludes from base income of the taxpayer any interest income received from a person who would be a member of the same unitary business group as the taxpayer, not to exceed the amount of interest expense of the taxpayer disallowed as a deduction because paid to the same 80-20 person.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subparagraph to reflect the expansion of the expense disallowance in (D-17).

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Exempted this subparagraph from automatic sunset under Section 250.

SECTION 203(a)(2)(EE)--INTANGIBLES INCOME SUBTRACTION

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, excludes from base income of the taxpayer any intangibles income whose deduction was disallowed to the payor under the 80-20 intangibles expense disallowance provisions.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subparagraph to reflect the expansion of the expense disallowance in (D-18).

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Exempted this subparagraph from automatic sunset under Section 250.

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SECTION 203(a)(2)(FF)--INSURANCE PREMIUM SUBTRACTION - DELETED

CREATED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Added this subparagraph to reflect the disallowance of insurance premium expenses in new subparagraph (D-19).

DELETED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Repealed this subparagraph as unnecessary.

SECTION 203(a)(2)(FF)--WRONGFUL IMPRISONMENT

CREATED BY:

PUBLIC ACT 96-1214 - EFFECTIVE: JULY 22, 2010

Added this subparagraph to allow a subtraction for damages received from the Illinois Court of Claims for wrongful imprisonment.

AMENDED BY:

No Amendments.

SECTION 203(a)(2)(GG)--SUBTRACTION FOR INSURANCE PAYMENTS

CREATED BY:

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Allows an elective subtraction for insured losses when the taxpayer was required to add back the premiums paid for the insurance under subparagraph (D-19).

SECTION 203(a)(2)(HH)--SUBTRACTION FOR ABLE ACCOUNT CONTRIBUTIONS

CREATED BY:

PUBLIC ACT 100-905 - EFFECTIVE: AUGUST 17, 2018

For tax years beginning on or after January 1, 2018, taxpayers are allowed a subtraction for up to $10,000 in contributions to an Illinois ABLE account.

SECTION 203(b)(1)--CORPORATIONS--IN GENERAL

CREATED BY:

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PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments.

SECTION 203(b)(2)--CORPORATIONS--MODIFICATIONS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

See Section 203(b)(2)(J) below.

ADDITION MODIFICATIONS

SECTION 203(b)(2)(A)--FEDERALLY TAX-EXEMPT INTEREST

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Required an addition for interest, which was not taxable federally.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Added the provision that "...all distributions received from regulated investment companies..." not included in taxable income must be added back.

SECTION 203(b)(2)(B)--ILLINOIS INCOME TAX DEDUCTED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Required an addition for the amount of Illinois Income Tax deducted from federal taxable income.

AMENDED BY:

No amendments.

SECTION 203(b)(2)(C)--CAPITAL GAINS ADDITION

CREATED BY:

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PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Required an addition for real estate investment trusts and regulated investment companies only for the excess of the net long-term capital gain over the capital gain dividends for the year.

AMENDED BY:

PUBLIC ACT 88-89 - EFFECTIVE: THIS IS DECLARATIVE OR EXISTING LAW AND IS NOT A NEW AMENDMENT.

The additional modification for RICs and REITs to equal the excess of the net long-term capital gain for the taxable year, over the amount of capital gain dividends designated as such in accordance with IRC Section 850 (b)(3)(C) or 852 (b)(3)(D) attributable to the taxable year.

PUBLIC ACT 90-491 - EFFECTIVE: JANUARY 1,1998

Eliminates REITs from the addition modification.

SECTION 203(b)(2)(D)--WESTERN HEMISPHERE TRADE CORPS - SPECIAL DEDUCTION--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Required an addition for Western Hemisphere trade corporations, China Trade Act corporations or IRC Section 931(a) possessions companies for the amount of special deductions or exclusions allowed by the IRC in the computation of federal taxable income.

DELETED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

SECTION 203(b)(2)(D)--FEDERAL NET OPERATING LOSS

CREATED BY:

PUBLIC ACT 84-1042 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

Required an addition for any federal net operating loss incurred in a tax year ending on or after December 31, 1986 which was used to reduce taxable income.

AMENDED BY:

No amendments.

SECTION 203(b)(2)(E)--EXCESS ADDITION MODIFICATION

CREATED BY:

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PUBLIC ACT 83-951 - EFFECTIVE: DECEMBER 1, 1983

Required an addition for the amount by which the addition modifications exceed the subtraction modifications in a year in which a federal net operating loss is incurred.

AMENDED BY:

PUBLIC ACT 84-1042 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

Deleted all references to "such earlier or later taxable years" and restricted the modification to net operating loss carryback or carryovers from taxable years ending prior to December 31, 1986.

SECTION 203(b)(2)(E-5)--ELIGIBLE REMEDIATION COSTS ADDITION

CREATED BY:

PUBLIC ACT 90-717 - EFFECTIVE: AUGUST 7, 1998

Requires an addition of any eligible remediation costs deducted in computing adjusted gross income for which the corporation claims the Environmental Remediation Credit

SECTION 203(b)(2)(E-10)--BONUS DEPRECIATION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

For taxable years 2001 and after, an addition for the amount equal to the bonus depreciation deduction taken on the taxpayer's federal income tax return under subsection (k) of Section 168 of the Internal Revenue Code.

SECTION 203(b)(2)(E-11)--BONUS DEPRECIATION DEDUCTION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

Requires an addition for an amount equal to the aggregate amount of the deductions taken in all taxable years under subparagraph (T) with respect to that property.

AMENDED BY:

PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

Requires add-back of bonus depreciation subtractions related to an asset that is sold, abandoned or disposed of in any manner during the tax year, or whose depreciable life terminates during the tax year.

SECTION 203(b)(2)(E-12)--INTEREST EXPENSE DISALLOWANCE

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CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, disallows the deduction of interest expense incurred in a transaction with a person that would be a member of the same unitary business group as the taxpayer if not for the 80-20 test.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Expands the deduction disallowance beginning with taxable years ending December 31, 2008, to apply to payments to a person who would be a member of the same unitary group as the taxpayer if not for the noncombination rule.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Made technical corrections to the amendments in Public Act 95-233.

SECTION 203(b)(2)(E-13)--INTANGIBLES EXPENSE DISALLOWANCE

CREATED BY:

PUBLIC ACT 93-840 – EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, disallows the deduction of certain intangible expenses incurred in a transaction with a person that would be a member of the same unitary business group as the taxpayer if not for the 80-20 test.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Expands the deduction disallowance beginning with taxable years ending December 31, 2008, to apply to payments to a person who would be a member of the same unitary group as the taxpayer if not for the noncombination rule.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Made technical corrections to the amendments in Public Act 95-233.

SECTION 203(b)(2)(E-14)--INSURANCE PREMIUM EXPENSE DISALLOWANCE

CREATED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Beginning with taxable years ending December 31, 2008, disallows the deduction of insurance premiums paid to a person who would be a member of the same unitary group as the taxpayer if not for the noncombination rule.

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AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Made technical corrections to the amendments in Public Act 95-233.

SECTION 203(b)(2)(E-15)--CAPTIVE REIT DIVIDEND--PAID DEDUCTION DISALLOWANCE

CREATED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Beginning with taxable years ending December 31, 2008, disallows the deduction allowed to a captive real estate investment trust for dividends paid to a corporation.

AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Disallows the deduction for all dividends paid by a captive REIT.

SECTION 203(b)(2)(E-16)--EMPLOYER CONTRIBUTIONS TO SECTION 529 PLANS

CREATED BY:

PUBLIC ACT 96-198 - EFFECTIVE: AUGUST 10, 2009

Requires an add-back equal to the credit allowed under Section 218 for employer contributions to Section 529 plans.

SECTION 203(b)(2)(E-17)—DOMESTIC PRODUCTION ACTIVITIES DEDUCTION

CREATED BY:

PUBLIC ACT 100-22 – EFFECTIVE: JULY 6, 2017

Requires the add-back of any domestic production activities deduction allowed under IRC Section 199 in taxable years ending on or after December 31, 2017.

SECTION 203(b)(2)(E-18)—FOREIGN DERIVED INTANGIBLE INCOME AND GLOBAL INTANGIBLE LOW-TAXED INCOME DEDUCTIONS

CREATED BY:

PUBLIC ACT 101-9 – EFFECTIVE: JUNE 5, 2019

Requies the add-back of deductions for foreign derived intangible income and global intangible low-taxed income under IRC Section 250.

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SUBTRACTION MODIFICATIONS

SECTION 203(b)(2)(F)--ILLINOIS INCOME TAX REFUNDS

CREATED BY:

PUBLIC ACT 77-627 - EFFECTIVE: AUGUST 4, 1971

Allowed a subtraction for the amount of Illinois Income Tax refunds, which were included in federal taxable income.

AMENDED BY:

No amendments.

SECTION 203(b)(2)(G)--FOREIGN DIVIDEND GROSS-UP

CREATED BY:

PUBLIC ACT 79-1022 - EFFECTIVE: FOR TAX YEARS ENDING AFTER DECEMBER 31, 1974

Allowed a subtraction for the amount of Section 78 "Gross-up" included in federal taxable income.

AMENDED BY:

No amendments.

SECTION 203(b)(2)(H)--EXEMPT INTEREST DIVIDENDS

CREATED BY:

PUBLIC ACT 80-580 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1977

Allowed a subtraction for regulated investment companies only for the amount of exempt interest dividends paid to the shareholders for the year.

AMENDED BY:

No amendments.

SECTION 203(b)(2)(I)--EXPENSES TO CARRY TAX-EXEMPT INTEREST

CREATED BY:

PUBLIC ACT 83-561 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER SEPTEMBER 17, 1983

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Allowed a subtraction for expenses, which are disallowed federally if they are related to federally tax-exempt interest.

AMENDED BY:

PUBLIC ACT 84-604 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER SEPTEMBER 19, 1985

Corrected IRC references. Added the statement, "...and amounts disallowed as interest expense by Section 291(a)(3)..."

PUBLIC ACT 89-460 - EFFECTIVE: DECLARATORY OF EXISTING LAW

Any expenses subtracted under Section 203(b)(2)(J) cannot also be deducted under this section.

PUBLIC ACT 91-541 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER AUGUST 13, 1999

With the exception of the amounts subtracted under subsection J, this amendment provides a subtraction modification equal to the sum of the amounts disallowed as deductions by Sections 171(a)(2), 265, 280C, and 832(b)(5)(B)(i) of the Internal Revenue Code; the provisions of this subparagraph are exempt from the provisions of Section 250.

By referencing Section 832(b)(5)(B)(i) of the Internal Revenue Code, this amendment provides a subtraction modification for non-life (primarily property and casualty) insurance companies for the 15% reduction to the “losses incurred” deduction allowed by IRC Section 832(b)(5). The effect of the reference to Section 832(b)(5)(B)(i) is to only require non-life insurance companies to include 85 percent of their municipal interest in Illinois base income.

PUBLIC ACT 91-845 - EFFECTIVE: JUNE 22, 2000

Added the effective date of Public Act 91-541.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Deleted extraneous language in reference to the IRC, added subtractions for IRC Sections 45G and 87, and amended the interest subtraction for insurance companies to take into account the adjustments to reserves required when exempt interest is received.

SECTION 203(b)(2)(J)--INCOME EXEMPT FROM TAX UNDER OTHER LAWS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Allowed a subtraction for the amount of income that is exempt from state taxation by reason of the Illinois, constitution or the United States constitution, statutes, or treaties. (This was the only subtraction allowed in the 1969 version of the IITA.)

AMENDED BY:

PUBLIC ACT 89-460 - EFFECTIVE: DECLARATORY OF EXISTING LAW.

The interest subtracted under this provision is net of bond premium amortization.

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PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

For taxable years ending on or after December 31, 2008, requires the add-back of expenses incurred to carry tax-exempt bonds.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Repeals the provisions of Public Act 95-233 requiring the add-back of expenses incurred to carry tax-exempt bonds.

SECTION 203(b)(2)(K)--REPLACEMENT TAX PAID--DELETED

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Allowed a subtraction for the amount of Replacement Tax incurred and paid for the year limited by the amount Personal Property taxes paid in 1978.

AMENDED BY:

PUBLIC ACT 81-1506 - EFFECTIVE: SEPTEMBER 25, 1980

Deleted all references to the 1978 Personal Property taxes paid limitation.

DELETED BY:

PUBLIC ACT 84-1042 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

SECTION 203(b)(2)(K)--ENTERPRISE ZONE DIVIDENDS

CREATED BY:

PUBLIC ACT 82-1019 - EFFECTIVE: DECEMBER 7, 1982

Allowed a subtraction for dividends included in taxable income which are received from corporations who conduct all of their business operations within an Enterprise Zone or zones.

AMENDED BY:

PUBLIC ACT 83-1114 - EFFECTIVE: JUNE 8, 1984

Amended the modification to include dividends from companies who performed substantially all of their operations within an Enterprise Zone or zones.

PUBLIC ACT 94-1021 - EFFECTIVE: JULY 12, 2006

Allows the subtraction for corporations conducting operations in a River Edge Redevelopment Zone. Exempts the subtraction from Section 250.

PUBLIC ACT 97-905 – EFFECTIVE: AUGUST 7, 2012

Deletes all references to enterprise zones.

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SECTION 203(b)(2)(L)--FOREIGN TRADE ZONE/SUB-ZONE--HIGH IMPACT BUSINESS DIVIDENDS

CREATED BY:

PUBLIC ACT 84-769 - EFFECTIVE: JANUARY 1, 1986

Allowed a subtraction for dividends received from corporations conducting their business operations within a Foreign Trade Zone and who have been designated as High Impact Businesses.

AMENDED BY:

PUBLIC ACT 84-1440 - EFFECTIVE: JANUARY 1, 1987

Expanded the modification to include Foreign Trade Sub-Zones.

PUBLIC ACT 91-845 - EFFECTIVE: JUNE 22, 2000

Added the effective date of Public Act 91-541.

SECTION 203(b)(2)(M)--INTEREST ON LOANS SECURED BY ENTERPRISE ZONE PROPERTY

CREATED BY:

PUBLIC ACT 82-1019 - EFFECTIVE: DECEMBER 7, 1982

Allowed a subtraction for financial organizations only for interest received on loans which are secured by property which has been successfully claimed as qualifying for the Replacement Tax Investment Credit.

AMENDED BY:

PUBLIC ACT 83-1114 - EFFECTIVE: JUNE 8, 1984

Essentially rewrote the modification. Loan must be secured by property, which is eligible for the Replacement Tax Investment Credit.

PUBLIC ACT 94-1021 - EFFECTIVE: JULY 12, 2006

Allows the subtraction for loans secured by property in a River Edge Redevelopment Zone. Exempts the subtraction from Section 250.

PUBLIC ACT 97-905 – EFFECTIVE: AUGUST 7, 2012

Deletes all references to enterprise zones.

PUBLIC ACT 101-9 – EFFECTIVE: JUNE 5, 2019

Corrects a typographical error.

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SECTION 203(b)(2)(M-1)--INTEREST ON LOANS SECURED BY HIGH IMPACT BUSINESS PROPERTY

CREATED BY:

PUBLIC ACT 84-769 - EFFECTIVE: JANUARY 1, 1986

Allowed a subtraction for financial organizations only for interest received on loans, which are secured by property which, is eligible for the High Impact Business Investment Credit.

AMENDED BY:

PUBLIC ACT 84-1440 - EFFECTIVE: JANUARY 2, 1987

Expanded modification to include property located in a Foreign Trade Sub-Zone.

SECTION 203(b)(2)(N)--DESIGNATED ZONE ORGANIZATIONS CONTRIBUTIONS

CREATED BY:

PUBLIC ACT 82-1019 - EFFECTIVE: DECEMBER 7, 1982

Allowed a subtraction for two times any contribution made to a designated zone organization.

AMENDED BY:

PUBLIC ACT 94-1021 - EFFECTIVE: JULY 12, 2006

Allows the subtraction for contributions to River Edge Redevelopment Zone organizations. Exempts the subtraction from Section 250.

SECTION 203(b)(2)(O)--FOREIGN SOURCE DIVIDENDS

CREATED BY:

PUBLIC ACT 82-1029 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1982

Allowed a subtraction for foreign source dividends (85% or 100%) to the extent included in taxable income.

AMENDED BY:

PUBLIC ACT 84-1455 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1988

Expanded the modification to include Subpart F income.

PUBLIC ACT 88-195 - EFFECTIVE: FOR TAX YEARS ENDING AFTER DECEMBER 31, 1992

Reduced the percentage of foreign source dividend allowed as a subtraction in (i) from 85% to a percentage equal to the percentage allowable under Section 243(a)(1) of the IRC.

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PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Beginning with taxable years ending December 31, 2008, allows deductions for dividends received from a captive real estate investment trust to the same extent as foreign dividends.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Makes technical corrections to the amendment in Public Act 95-233 and exempts this subparagraph from automatic sunset under Section 250.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Extended the Subpart F reference to include IRC Section 965 in addition to IRC Sections 951 through 964.

SECTION 203(b)(2)(P)--PRAIRIE STATE 2000 FUND--DELETED

CREATED BY:

PUBLIC ACT 83-650 - EFFECTIVE: SEPTEMBER 23, 1983

Allowed a subtraction for premiums paid to the Prairie State 2000 Fund.

DELETED BY:

PUBLIC ACT 84-1090 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

The modification was also deleted by Public Act 84-1042 effective for tax years ending on or after December 31, 1986.

SECTION 203(b)(2)(P)--TRAINING EXPENSES--DELETED

CREATED BY:

PUBLIC ACT 83-650 - EFFECTIVE: SEPTEMBER 23, 1983

Allowed a subtraction for training expenses for employees in semi-skilled or skilled or semi-technical or technical fields except for amounts paid as premiums to the Prairie State 2000 Fund.

AMENDED BY:

PUBLIC ACT 84-1090 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

Rewrote the modification deleting all references to the Prairie State 2000 Fund.

DELETED BY:

PUBLIC ACT 84-1405 - EFFECTIVE: SEPTEMBER 18, 1986

SECTION 203(b)(2)(P)--JOB TRAINING PROJECT CONTRIBUTIONS

CREATED BY:

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PUBLIC ACT 84-1090 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

Allowed a subtraction for contributions made to a job-training project established pursuant to the "Real Property Tax Increment Allocation Redevelopment Act."

AMENDED BY:

No amendments.

SECTION 203(b)(2)(Q)--CLAIM OF RIGHT

CREATED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Allowed a subtraction for restoration of substantial amounts held under the claim of right federal statutes to the extent they are deducted from the computation of federal taxable income.

AMENDED BY:

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Deleted extraneous language in reference to the IRC.

SECTION 203(b)(2)(R)--CONTRIBUTIONS TO COMMUNITY BASED ORGANIZATIONS--DELETED

CREATED BY:

PUBLIC ACT 84-997 - EFFECTIVE: JANUARY 1, 1986

Allowed a subtraction for contributions made to community-based organizations.

AMENDED BY:

PUBLIC ACT 84-1308 - EFFECTIVE: AUGUST 25, 1986

Expanded the modification to include contributions made "...to assist local government programs for gang control."

DELETED BY:

PUBLIC ACT 84-1400 - EFFECTIVE: SEPTEMBER 18, 1986

SECTION 203(b)(2)(R)--ATTORNEY-IN-FACT

CREATED BY:

PUBLIC ACT 91-205 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JULY 20, 1999

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Creates a new subtraction modification for an attorney-in-fact with respect to whom an interinsurer or a reciprocal insurer has made an election under Section 835 of the Internal Revenue Code (IRC). The subtraction modification is equal to the excess, if any, of the amounts paid or incurred by that interinsurer or reciprocal insurer in the taxable year to the attorney-in-fact over the deduction allowed to that interinsurer or reciprocal insurer with respect to the attorney-in-fact under Section 835(b) of the IRC for the taxable year.

Prior to the effective date of Public Act 91-205, when an interinsurer or a reciprocal insurer makes an election under IRC Section 835, for Illinois purposes the income is taxed to both the attorney-in-fact and the reciprocal insurer.

AMENDED BY:

PUBLIC ACT 94-789 - EFFECTIVE: MAY 19, 2006

Retroactively re-enacts the subtraction, which had been sunset under Section 250. Exempts the subtraction from Section 250.

SECTION 203(b)(2)(S)--DISTRIBUTIONS TO REPLACEMENT TAX PAYING SHAREHOLDERS

CREATED BY:

PUBLIC ACT 91-913 - EFFECTIVE: JANUARY 1, 2001

Provides a subtraction modification for Subchapter S corporations for income distributable to shareholders subject to replacement tax for tax years ending on or after December 31, 1997

AMENDED BY:

No amendments.

SECTION 203(b)(2)(T)--DEPRECIATION DEDUCTION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

For taxable years 2001 and after, an amount equal to 42.9% of the amount of the federal depreciation deduction taken for the taxable year on property for which the bonus depreciation deduction was taken, but not including the bonus depreciation deduction.

AMENDED BY:

PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

For tax years ending after December 31, 2005, allows the subtraction of 100% of the federal depreciation deduction of an asset on which 50% bonus depreciation was claimed. Exempts the subtraction from Section 250.

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SECTION 203(b)(2)(U)--BONUS DEPRECIATION DEDUCTION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

An amount equal to the addition modification under subparagraph (E-10) if a taxpayer reports a capital gain or loss based on a sale or transfer of property for which the taxpayer was required to make an addition modification under subparagraph (E-10).

AMENDED BY:

PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

Allows the subtraction of bonus depreciation additions related to an asset that is sold, abandoned or disposed of in any manner during the tax year, or whose depreciable life terminates during the tax year. Exempts the subtraction from Section 250.

SECTION 203(b)(2)(V)--INTEREST AND INTANGIBLE INCOME SUBTRACTION

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, excludes from base income of the taxpayer any interest income whose deduction was disallowed to the payor under the 80-20 interest expense disallowance provisions.

AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Allowed a subtraction for premiums received from an affiliate, to the extent disallowed by Public Act 95-233, and exempted this subparagraph from automatic sunset under Section 250.

SECTION 203(b)(2)(W)--SUBTRACTION FOR INTEREST FROM 80-20 COMPANY

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, excludes from base income of the taxpayer any interest income received from a person who would be a member of the same unitary business group as the taxpayer, not to exceed the amount of interest expense of the taxpayer disallowed as a deduction because paid to the same 80-20 person.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subparagraph to reflect the expansion of the expense disallowance in (E-12) and (E-13).

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PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Allowed a subtraction for premiums received from an affiliate, to the extent disallowed by Public Act 95-233, and exempted this subparagraph from automatic sunset under Section 250.

SECTION 203(b)(2)(X)--INTANGIBLES INCOME SUBTRACTION

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, excludes from base income of the taxpayer any intangibles income whose deduction was disallowed to the payor under the 80-20 intangibles expense disallowance provisions.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subparagraph to reflect the expansion of the expense disallowance in (E-12) and (E-13).

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Exempted this subparagraph from automatic sunset under Section 250.

SECTION 203(b)(2)(Y)--SUBTRACTION FOR INSURANCE PAYMENTS

CREATED BY:

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Allows an elective subtraction for insured losses when the taxpayer was required to add back the premiums paid for the insurance under subparagraph (E-14).

SECTION 203(b)(2)(Z)--SUBTRACTION FOR IRC 965 INCOME

CREATED BY:

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Allows a subtraction to reverse the effects of IRC Section 965(e)(2)(A), which provides that taxable income may not be less than IRC Section 965 dividend income.

SECTION 203(b)(2)(FF)--INSURANCE PREMIUM SUBTRACTION - DELETED

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CREATED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Added this subparagraph to reflect the disallowance of insurance premium expenses in new subparagraph (E-14).

DELETED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Repealed this subparagraph as unnecessary.

SECTION 203(b)(3)--CORPORATIONS--SPECIAL RULE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provides a special rule, which states that for purposes of Section 203(b)(2)(A), “gross income” of a life insurance company, means the company's share of the gross investment income for the year.

AMENDED BY:

PUBLIC ACT 88-648 - EFFECTIVE DATE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1994

Amends the special rule to state that for purposes of Section 203(b)(2)(A), "gross income" of a life insurance company, means the gross investment income for the taxable year.

PA 88-669 also made this same amendment.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Corrected the references to insurance company gross income.

SECTION 203(c)(1)--TRUSTS AND ESTATES--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments.

SECTION 203(c)(2)--TRUSTS AND ESTATES--MODIFICATIONS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

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AMENDED BY:

See Section 203(c)(2)(K) below.

ADDITION MODIFICATIONS

SECTION 203(c)(2)(A)--FEDERALLY TAX-EXEMPT INTEREST

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Required an addition for interest, which was not taxable federally.

AMENDED BY:

No amendments.

SECTION 203(c)(2)(B)--CAPITAL GAIN ADDITION--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Required an addition modification for 50% of the excess net long-term capital gain over the net short-term capital loss, to the extent excluded from taxable income.

AMENDED BY:

PUBLIC ACT 81-444 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1979

Substituted reference to IRC Section 1202 for 50% of the excess of the net long-term capital gain.

PUBLIC ACT 84-1390 - EFFECTIVE: SEPTEMBER 18, 1986

Amended the addition to exclude charitable deductions under IRS Section 642(c).

DELETED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

SECTION 203(c)(2)(B)--TRUST/ESTATE ADDITION

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Required an addition of $600 for estates, $300 for trusts which are required to distribute all income currently, and $100 for all other trusts.

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AMENDED BY:

No amendments.

SECTION 203(c)(2)(C)--INCOME TAX DEDUCTED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Required an addition modification for the amount of Income Tax excluded in the computation of taxable income.

AMENDED BY:

No amendments.

SECTION 203(c)(2)(D)--FEDERAL NET OPERATING LOSS

CREATED BY:

PUBLIC ACT 84-1042 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

Required an addition for any federal net operating loss incurred in a tax year ending on or after December 31, 1986 which was used to reduce taxable income.

AMENDED BY:

No amendments.

SECTION 203(c)(2)(E)--EXCESS ADDITION MODIFICATION

CREATED BY:

PUBLIC ACT 83-951 - EFFECTIVE: DECEMBER 1, 1983

Required an addition for the amount by which the addition modifications exceed the subtraction modifications in a year in which a federal net operating loss is incurred.

AMENDED BY:

PUBLIC ACT 84-1042 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

Deleted all references to "such earlier or later taxable year(s)" and restricted the modification to net operating loss carrybacks or carryovers from taxable years ending prior to December 31, 1986.

SECTION 203(c)(2)(F)--SECTION 164 DEDUCTION

CREATED BY:

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PUBLIC ACT 85-1200 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1989

An amount equal to the tax deducted pursuant to Section 164 of the IRC if the trust or estate is claiming the same tax for purposes of the Illinois foreign tax credit under Section 601 of the IITA.

AMENDED BY:

No amendments.

SECTION 203(c)(2)(G)--CAPITAL GAIN ADDITION

CREATED BY:

PUBLIC ACT 86-678 - EFFECTIVE: SEPTEMBER 1, 1989

Required an addition for the amount of capital gain deduction allowed federally, to the extent deducted from the computation of taxable income.

AMENDED BY:

No amendments.

SECTION 203(c)(2)(G-5)--ELIGIBLE REMEDIATION COSTS ADDITION

CREATED BY:

PUBLIC ACT 90-717 - EFFECTIVE: AUGUST 7, 1998

Requires an addition of any eligible remediation costs deducted in computing adjusted gross income for which the trust or estate claims the Environmental Remediation Credit.

SECTION 203(c)(2)(G-10)--BONUS DEPRECIATION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

For taxable years 2001 and after, an addition for the amount equal to the bonus depreciation deduction taken on the taxpayer's federal income tax return under subsection (k) of Section 168 of the Internal Revenue Code.

SECTION 203(c)(2)(G-11)--BONUS DEPRECIATION DEDUCTION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

Requires an addition for an amount equal to the aggregate amount of the deductions taken in all taxable years under subparagraph (R) with respect to that property.

AMENDED BY:

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PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

Requires add-back of bonus depreciation subtractions related to an asset that is sold, abandoned or disposed of in any manner during the tax year, or whose depreciable life terminates during the tax year.

SECTION 203(c)(2)(G-12)--INTEREST EXPENSE DISALLOWANCE

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, disallows the deduction of interest expense incurred in a transaction with a person that would be a member of the same unitary business group as the taxpayer if not for the 80-20 test.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Expands the deduction disallowance beginning with taxable years ending December 31, 2008, to apply to payments to a person who would be a member of the same unitary group as the taxpayer if not for the noncombination rule.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Made technical corrections to the amendments in Public Act 95-233.

SECTION 203(c)(2)(G-13)--INTANGIBLES EXPENSE DISALLOWANCE

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, disallows the deduction of certain intangible expenses incurred in a transaction with a person that would be a member of the same unitary business group as the taxpayer if not for the 80-20 test.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Expands the deduction disallowance beginning with taxable years ending December 31, 2008, to apply to payments to a person who would be a member of the same unitary group as the taxpayer if not for the noncombination rule.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Made technical corrections to the amendments in Public Act 95-233.

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SECTION 203(c)(2)(G-14)--INSURANCE PREMIUM EXPENSE DISALLOWANCE

CREATED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Beginning with taxable years ending December 31, 2008, disallows the deduction of insurance premiums paid to a person who would be a member of the same unitary group as the taxpayer if not for the noncombination rule.

AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Made technical corrections to the amendments in Public Act 95-233.

SECTION 203(c)(2)(G-15)--EMPLOYER CONTRIBUTIONS TO SECTION 529 PLANS

CREATED BY:

PUBLIC ACT 96-198 - EFFECTIVE: AUGUST 10, 2009

Requires an add-back equal to the credit allowed under Section 218 for employer contributions to Section 529 plans.

SECTION 203(c)(2)(G-16)—DOMESTIC PRODUCTION ACTIVITIES DEDUCTION

CREATED BY:

PUBLIC ACT 100-22 – EFFECTIVE: JULY 6, 2017

Requires the add-back of any domestic production activities deduction allowed under IRC Section 199 in taxable years ending on or after December 31, 2017.

SUBTRACTION MODIFICATIONS

SECTION 203(c)(2)(H)--RETIREMENT PAY

CREATED BY:

PUBLIC ACT 77-669 - EFFECTIVE: FOR TAX YEARS BEGINNING AFTER DECEMBER 31, 1970

Allowed a subtraction for payments from certain retirement plans provided for in Sections 402-407 of the IRC.

AMENDED BY:

PUBLIC ACT 77-2062 - EFFECTIVE: FOR TAX YEARS BEGINNING AFTER DECEMBER 31, 1971

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Added the statement, "...or included in such total as distributions under the provisions of any retirement or disability plan for employees of any governmental agency or unit..."

PUBLIC ACT 79-1426 - EFFECTIVE: TAX YEARS ENDING AFTER DECEMBER 31, 1976

Added the references to IRC Sections 408 and 409.

PUBLIC ACT 83-1498 - EFFECTIVE: DECEMBER 27, 1984
PUBLIC ACT 83-1500 - EFFECTIVE: DECEMBER 27, 1984

Added the statement, "...or retirement payments to retired partners..."

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Deleted references to repealed sections of the IRC for payments from employee benefit, retirement plans and social security.

SECTION 203(c)(2)(I)--VALUATION LIMITATION AMOUNT

CREATED BY:

PUBLIC ACT 77-669 - EFFECTIVE: FOR TAX YEARS BEGINNING AFTER DECEMBER 31, 1970

Allowed a subtraction for the valuation limitation amount described in Section 203(f).

AMENDED BY:

No amendments.

SECTION 203(c)(2)(J)--REPLACEMENT TAX PAID--DELETED

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Allowed a subtraction for the amount of Replacement Tax incurred and paid for the year limited by the amount Personal Property taxes paid in 1978.

AMENDED BY:

PUBLIC ACT 81-1506 - EFFECTIVE: SEPTEMBER 25, 1980

Deleted all references to the 1978 Personal Property taxes paid limitation.

DELETED BY:

PUBLIC ACT 84-1042 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

SECTION 203(c)(2)(J)--INCOME TAX REFUNDS

CREATED BY:

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PUBLIC ACT 77-627 - EFFECTIVE: AUGUST 4, 1971

Allowed a subtraction for the amount of Illinois income tax refund included in taxable income for the taxable year.

AMENDED BY:

No amendments.

SECTION 203(c)(2)(K)--INCOME EXEMPT FROM TAX UNDER OTHER LAWS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Allowed a subtraction for income that is exempt from state taxation by virtue of Illinois', constitution and/or statutes or the United States constitution, treaties and/or statutes. (This was the only subtraction allowed in the original IITA and was not given a separate subparagraph letter in the original Act.)

AMENDED BY:

PUBLIC ACT 89-460 - EFFECTIVE: DECLARATORY OF EXISTING LAW

The interest subtracted under this provision is net of bond premium amortization.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

For taxable years ending on or after December 31, 2008, requires the add-back of expenses incurred to carry tax-exempt bonds.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Repeals the provisions of Public Act 95-233 requiring the add-back of expenses incurred to carry tax-exempt bonds.

SECTION 203(c)(2)(L)--FEDERALLY DISALLOWED EXPENSES/INTEREST

CREATED BY:

PUBLIC ACT 83-561 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER SEPTEMBER 17, 1983

Allowed a subtraction for expenses relating to federally tax-exempt obligations.

AMENDED BY:

PUBLIC ACT 89-460 - EFFECTIVE: DECLARATORY OF EXISTING LAW

Any expenses subtracted under Section 203(c)(2)(K) cannot also be deducted under this section.

PUBLIC ACT 91-541 - EFFECTIVE FOR TAX YEARS ENDING ON OR AFTER AUGUST 13, 1999

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With the exception of the amounts subtracted under subsection K, this amendment provides a subtraction modification equal to the sum of the amounts disallowed as deductions by Sections 171(a)(2), 265, 280C, and 832(b)(5)(B)(i) of the Internal Revenue Code; the provisions of this subparagraph are exempt from the provisions of Section 250.

PUBLIC ACT 91-913 - EFFECTIVE: JANUARY 1, 2001

Added the effective date of Public Act 91-541.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Deleted extraneous language in reference to the IRC and added subtractions for IRC Section45G and 87.

PUBLIC ACT 101-9- EFFECTIVE: JUNE 5, 2019 AND PUBLIC ACT 101-81 – EFFECTIVE: JULY 12, 2019

Corrects references to IRC 265.

SECTION 203(c)(2)(M)--CONTRIBUTIONS TO COMMUNITY BASED ORGANIZATIONS--DELETED

CREATED BY:

PUBLIC ACT 84-997 - EFFECTIVE: JANUARY 1, 1986

Allowed a subtraction for contributions made to community-based organizations.

AMENDED BY:

PUBLIC ACT 84-1308 - EFFECTIVE: AUGUST 25, 1986

Expanded the modification to include contributions made "...to assist local government programs for gang control."

DELETED BY:

PUBLIC ACT 84-1400 - EFFECTIVE: SEPTEMBER 18, 1986

SECTION 203(c)(2)(M)--ENTERPRISE ZONE DIVIDENDS

CREATED BY:

PUBLIC ACT 82-1019 - EFFECTIVE: DECEMBER 7, 1982

Allowed a subtraction for dividends received from corporations operating exclusively in an Enterprise Zone or zones.

AMENDED BY:

PUBLIC ACT 83-1114 - EFFECTIVE: JUNE 8, 1984

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Changed requirement that the corporation operate exclusively in the Enterprise Zone or zones to "conducts substantially all of its operations" in the Zone or zones.

PUBLIC ACT 94-1021 - EFFECTIVE: JULY 12, 2006

Allows the subtraction for corporations conducting operations in a River Edge Redevelopment Zone. Exempts the subtraction from Section 250.

PUBLIC ACT 97-905 – EFFECTIVE: AUGUST 7, 2012

Deletes all references to enterprise zones.

SECTION 203(c)(2)(N)--JOB TRAINING PROJECT CONTRIBUTIONS

CREATED BY:

PUBLIC ACT 84-1090 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

Allowed a subtraction for contributions made to a job-training project established pursuant to the "Real Property Tax Increment Allocation Redevelopment Act."

AMENDED BY:

No amendments.

SECTION 203(c)(2)(O)--FOREIGN TRADE ZONE/SUB-ZONE DIVIDENDS

CREATED BY:

PUBLIC ACT 84-769 - EFFECTIVE: JANUARY 1, 1986

Allowed a subtraction for dividends received from corporations designated as High Impact Businesses located in a Foreign Trade Zone or zones, if the dividend is not eligible to be deducted under Section 203(c)(2)(K).

AMENDED BY:

PUBLIC ACT 84-1440 - EFFECTIVE: JANUARY 2, 1987

Expanded the modification to businesses designated as High Impact Businesses and located in a Foreign Trade Sub-Zone.

SECTION 203(c)(2)(P)--CLAIM OF RIGHT

CREATED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987.

Allowed a subtraction for restoration of substantial amounts held under the claim of right federal statutes to the extent they are deducted from the computation of federal taxable income.

AMENDED BY:

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PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Deleted extraneous language in reference to the IRC.

SECTION 203(c)(2)(Q)--NAZI PERSECUTION SUBTRACTION MODIFICATION

CREATED BY:

PUBLIC ACT 91-676 - EFFECTIVE: FOR TAXABLE YEAR 1999

Creates a subtraction modification equal to the amount of distributions and items of income received by the taxpayer because of his or her status as a victim or descendant of a victim of Nazi persecution.

AMENDED BY:

No Amendments.

SECTION 203(c)(2)(R)--DEPRECIATION DEDUCTION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

For taxable years 2001 and after, an amount equal to 42.9% of the amount of the federal depreciation deduction taken for the taxable year on property for which the bonus depreciation deduction was taken, but not including the bonus depreciation deduction.

AMENDED BY:

PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

For tax years ending after December 31, 2005, allows the subtraction of 100% of the federal depreciation deduction of an asset on which 50% bonus depreciation was claimed. Exempts the subtraction from Section 250.

SECTION 203(c)(2)(S)--BONUS DEPRECIATION DEDUCTION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

An amount equal to the addition modification under subparagraph (G-10) if a taxpayer reports a capital gain or loss based on a sale or transfer of property for which the taxpayer was required to make an addition modification under subparagraph (G-10).

AMENDED BY:

PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

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Allows the subtraction of bonus depreciation additions related to an asset that is sold, abandoned or disposed of in any manner during the tax year, or whose depreciable life terminates during the tax year. Exempts the subtraction from Section 250.

SECTION 203(c)(2)(T)--INTEREST INCOME SUBTRACTION

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, excludes from base income of the taxpayer any interest income whose deduction was disallowed to the payor under the 80-20 interest expense disallowance provisions.

AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Exempted this subparagraph from automatic sunset under Section 250.

SECTION 203(c)(2)(U)--SUBTRACTION FOR INTEREST FROM AFFILIATED COMPANY

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, excludes from base income of the taxpayer any interest income received from a person who would be a member of the same unitary business group as the taxpayer, not to exceed the amount of interest expense of the taxpayer disallowed as a deduction because paid to the same 80-20 person.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subparagraph to reflect the expansion of the expense disallowance in (G-12).

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Exempted this subparagraph from automatic sunset under Section 250.

SECTION 203(c)(2)(V)--INTANGIBLES INCOME SUBTRACTION

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, excludes from base income of the taxpayer any intangibles income whose deduction was disallowed to the payor under the 80-20 interest expense disallowance provisions.

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AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Amended this subparagraph to reflect the expansion of the expense disallowance in (G-13) and to exempt it from automatic sunset under Section 250.

SECTION 203(c)(2)(W)--ITEMIZED DEDUCTIONS OF DECEDENT

CREATED BY:

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Allows estates to subtract federally taxed recoveries of itemized incomes claimed by the decedent.

SECTION 203(c)(2)(X)--REFUND OF TAXES PAID TO OTHER STATES

CREATED BY:

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Allows a subtraction for federally taxed refunds of other state's taxes when the trust or estate had added back the federal deduction for the tax when claiming a credit for the taxes.

SECTION 203(c)(2)(Y)--SUBTRACTION FOR INSURANCE PAYMENTS

CREATED BY:

PUBLIC ACT 97-0507-EFFECTIVE: AUGUST 23, 2011

Allows an elective subtraction for insured losses when the taxpayer was required to add back the premiums paid for the insurance under subparagraph (G-14).

SECTION 203(c)(2)(FF)--INSURANCE PREMIUM SUBTRACTION - DELETED

CREATED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Added this subparagraph to reflect the disallowance of insurance premium expenses in new subparagraph (G-14).

DELETED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Repealed this subparagraph as unnecessary.

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SECTION 203(c)(3)--LIMITATION

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provides that any modification contained in Section 203(c)(2) should be reduced by any amount of the modification, which was properly paid, credited, or required to be distributed for the tax year.

AMENDED BY:

PUBLIC ACT 84-1400 - EFFECTIVE: SEPTEMBER 18, 1986

Extended limitation to exclude amounts, which are permanently set aside for charitable purposes under IRC Section 642(c).

SECTION 203(d)(1)--PARTNERSHIPS--IN GENERAL

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

AMENDED BY:

No amendments.

SECTION 203(d)(2)--PARTNERSHIPS--MODIFICATION

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

AMENDED BY:

No amendments.

ADDITION MODIFICATIONS

SECTION 203(d)(2)(A)--FEDERALLY TAX-EXEMPT INTEREST

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Requires an addition to taxable income for all amounts paid or accrued by the partnership as interest or dividends, which are excluded from federal taxable income.

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AMENDED BY:

No amendments.

SECTION 203(d)(2)(B)--INTERNAL REVENUE CODE SECTION 1202 ADDITION--DELETED

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Required an addition of the amount deducted under Section 1202 of the IRC.

DELETED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

SECTION 203(d)(2)(B)--REPLACEMENT TAX DEDUCTED

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Requires an addition for any RT deducted from federal taxable income.

AMENDED BY:

No amendments.

SECTION 203(d)(2)(C)--INTERNAL REVENUE CODE SECTION 707(c) ADD-BACK

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Requires an addition for the amount of IRC Section 707(c) deductions, which reduced taxable income.

AMENDED BY:

PUBLIC ACT 96-45 - EFFECTIVE: JULY 15, 2009

Amended this paragraph so that no add-back is required in taxable years ending on or after December 31, 2009, for guaranteed payments to an individual partner for personal services.

PUBLIC ACT 96-835 - EFFECTIVE: DECEMBER 16, 2009

Reverses the changes made by Public Act 96-45.

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SECTION 203(d)(2)(D)--CAPITAL GAIN ADDITION

CREATED BY:

PUBLIC ACT 86-678 - EFFECTIVE: SEPTEMBER 1, 1989

Required an addition for the amount of capital gain deduction allowed federally, to the extent deducted from the computation of taxable income.

AMENDED BY:

No amendments.

SECTION 203(d)(2)(D-5)--BONUS DEPRECIATION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

For taxable years 2001 and after, an addition for the amount equal to the bonus depreciation deduction taken on the taxpayer's federal income tax return under subsection (k) of Section 168 of the Internal Revenue Code.

SECTION 203(d)(2)(D-6)--BONUS DEPRECIATION DEDUCTION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

Requires an addition for an amount equal to the aggregate amount of the deductions taken in all taxable years under subparagraph (O) with respect to that property.

AMENDED BY:

PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

Requires add-back of bonus depreciation subtractions related to an asset that is sold, abandoned or disposed of in any manner during the tax year, or whose depreciable life terminates during the tax year.

SECTION 203(d)(2)(D-7)--INTEREST EXPENSE DISALLOWANCE

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, disallows the deduction of interest expense incurred in a transaction with a person that would be a member of the same unitary business group as the taxpayer if not for the 80-20 test.

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AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Expands the deduction disallowance beginning with taxable years ending December 31, 2008, to apply to payments to a person who would be a member of the same unitary group as the taxpayer if not for the noncombination rule.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Made technical corrections to the amendments in Public Act 95-233.

SECTION 203(d)(2)(D-8)--INTANGIBLES EXPENSE DISALLOWANCE

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, disallows the deduction of certain intangible expenses incurred in a transaction with a person that would be a member of the same unitary business group as the taxpayer if not for the 80-20 test.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Expands the deduction disallowance beginning with taxable years ending December 31, 2008, to apply to payments to a person who would be a member of the same unitary group as the taxpayer if not for the noncombination rule.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Made technical corrections to the amendments in Public Act 95-233.

SECTION 203(d)(2)(D-9)--INSURANCE PREMIUM EXPENSE DISALLOWANCE

CREATED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Beginning with taxable years ending December 31, 2008, disallows the deduction of insurance premiums paid to a person who would be a member of the same unitary group as the taxpayer if not for the noncombination rule.

AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Made technical corrections to the amendments in Public Act 95-233.

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SECTION 203(d)(2)(D-10)--EMPLOYER CONTRIBUTIONS TO SECTION 529 PLANS

CREATED BY:

PUBLIC ACT 96-198 - EFFECTIVE: AUGUST 10, 2009

Requires an add-back equal to the credit allowed under Section 218 for employer contributions to Section 529 plans.

SECTION 203(d)(2)(D-11)—DOMESTIC PRODUCTION ACTIVITIES DEDUCTION

CREATED BY:

PUBLIC ACT 100-22 – EFFECTIVE: JULY 6, 2017

Requires the add-back of any domestic production activities deduction allowed under IRC Section 199 in taxable years ending on or after December 31, 2017.

SUBTRACTION MODIFICATIONS

SECTION 203(d)(2)(E)--VALUATION LIMITATION

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Allowed a subtraction for the valuation limitation amount described in Section 203(f).

AMENDED BY:

No amendments.

SECTION 203(d)(2)(F)--REPLACEMENT TAX REFUND

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Allowed a subtraction for the amount of Illinois replacement tax refund included in taxable income for the taxable year.

AMENDED BY:

No amendments.

SECTION 203(d)(2)(G)--INCOME EXEMPT FROM TAX UNDER OTHER LAWS

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CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Allowed a subtraction for income that is exempt from state taxation by virtue of Illinois' constitution and/or statutes or the United States constitution, treaties and/or statutes.

AMENDED BY:

PUBLIC ACT 89-460 - EFFECTIVE: DECLARATORY OF EXISTING LAW

The interest subtracted under this provision is net of bond premium amortization.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

For taxable years ending on or after December 31, 2008, requires the add-back of expenses incurred to carry tax-exempt bonds.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Repeals the provisions of Public Act 95-233 requiring the add-back of expenses incurred to carry tax-exempt bonds.

SECTION 203(d)(2)(H)--PARTNER COMPENSATION AMOUNTS

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Allowed a subtraction for any amounts paid or accrued for services rendered by partners or any amounts which constitute personal service income, whichever is greater.

AMENDED BY:

PUBLIC ACT 84-127 - EFFECTIVE: AUGUST 1, 1985

Revised obsolete reference to an IRC Section to provide that personal service income deductible by a partnership is defined by the IRC as in effect December 31, 1981.

PUBLIC ACT 96-45 - EFFECTIVE: JULY 15, 2009

Repealed this subtraction, effective for tax years ending on or after December 31, 2009.

PUBLIC ACT 96-835 - EFFECTIVE: DECEMBER 16, 2009

Reverses the changes made by Public Act 96-45.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Exempts this subparagraph from automatic sunset under Section 250.

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SECTION 203(d)(2)(I)--DISTRIBUTIONS TO REPLACEMENT TAX PAYING PARTNERS

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Allowed a subtraction for all amounts distributed to entities, which are subject to Replacement Tax.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Specifically states that the modification is allowable for distributions to entities which are exempt from federal income tax by reason of Section 501(a) of the IRC.

PUBLIC ACT 96-520 - EFFECTIVE: AUGUST 14, 2009

Disallows the subtraction for publicly-traded partnerships for tax years ending on or after December 31, 2009.

PUBLIC ACT 96-0935- EFFECTIVE: JUNE 21, 2010

Repeals the disallowance of the subtraction for publicly-traded partnerships.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Exempts this subparagraph from automatic sunset under Section 250.

SECTION 203(d)(2)(J)--FEDERALLY DISALLOWED EXPENSES/INTEREST

CREATED BY:

PUBLIC ACT 83-561 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER SEPTEMBER 17, 1983

Allowed a subtraction for expenses relating to federally tax-exempt obligations.

AMENDED BY:

PUBLIC ACT 89-460 - EFFECTIVE: DECLARATORY OF EXISTING LAW

Any expenses subtracted under Section 203(d)(2)(G) cannot also be deducted under this section.

PUBLIC ACT 91-541 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER AUGUST 13, 1999

With the exception of the amounts subtracted under subsection G, this amendment provides a subtraction modification equal to the sum of the amounts disallowed as deductions by Sections 171(a)(2), 265, 280C, and 832(b)(5)(B)(i) of the Internal Revenue Code; the provisions of this subparagraph are exempt from the provisions of Section 250.

PUBLIC ACT 91-845 - EFFECTIVE: JUNE 22, 2000

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Added the effective date of Public Act 91-541.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Deleted extraneous language in reference to the IRC and added subtraction for IRC Sections 45G and 87.

PUBLIC ACT 101-9- EFFECTIVE: JUNE 5, 2019 AND PUBLIC ACT 101-81 – EFFECTIVE JULY 12, 2019

Corrects references to IRC Section 265.

SECTION 203(d)(2)(K)--ENTERPRISE ZONE DIVIDENDS

CREATED BY:

PUBLIC ACT 82-1019 - EFFECTIVE: DECEMBER 7, 1982

Allowed a subtraction for dividends received from corporations operating exclusively in an Enterprise Zone or zones.

AMENDED BY:

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Added the wording “conducts substantially all of its operations” and deleted the wording “which does not conduct such operations other than”.

PUBLIC ACT 94-1021 - EFFECTIVE: JULY 12, 2006

Allows the subtraction for corporations conducting operations in a River Edge Redevelopment Zone. Exempts the subtraction from Section 250.

PUBLIC ACT 97-905 – EFFECTIVE: AUGUST 7, 2012

Deletes all references to enterprise zones.

SECTION 203(d)(2)(L)--CONTRIBUTIONS TO COMMUNITY BASED ORGANIZATIONS--DELETED

CREATED BY:

PUBLIC ACT 84-997 - EFFECTIVE: JANUARY 1, 1986

Allowed a subtraction for contributions made to community-based organizations.

AMENDED BY:

PUBLIC ACT 84-1308 - EFFECTIVE: AUGUST 25, 1986

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Expanded the modification to include contributions made "...to assist local government programs for gang control."

DELETED BY:

PUBLIC ACT 84-1400 - EFFECTIVE: SEPTEMBER 18, 1986

SECTION 203(d)(2)(L)--JOB TRAINING CONTRIBUTIONS

CREATED BY:

PUBLIC ACT 84-1090 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

Allowed a subtraction for contributions made to a job-training project established pursuant to the "Real Property Tax Increment Allocation Redevelopment Act."

AMENDED BY:

No amendments.

SECTION 203(d)(2)(M)--FOREIGN TRADE ZONE/SUB-ZONE DIVIDENDS

CREATED BY:

PUBLIC ACT 84-769 - EFFECTIVE: JANUARY 1, 1986

Allowed a subtraction for dividends received from corporations designated as High Impact Businesses located in a Foreign Trade Zone or zones, if the dividend is not eligible to be deducted under Section 203(d)(2)(J).

AMENDED BY:

PUBLIC ACT 84-1440 - EFFECTIVE: JANUARY 2, 1987

Expanded the modification to businesses designated as High Impact Businesses and located in a Foreign Trade Sub-Zone.

SECTION 203(d)(2)(N)--CLAIM OF RIGHT

CREATED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987.

Allowed a subtraction for restoration of substantial amounts held under the claim of right federal statutes to the extent they are deducted from the computation of federal taxable income.

AMENDED BY:

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Deleted extraneous language in reference to the IRC.

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SECTION 203(d)(2)(O)--DEPRECIATION DEDUCTION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

For taxable years 2001 and after, an amount equal to 42.9% of the amount of the federal depreciation deduction taken for the taxable year on property for which the bonus depreciation deduction was taken, but not including the bonus depreciation deduction.

AMENDED BY:

PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

For tax years ending after December 31, 2005, allows the subtraction of 100% of the federal depreciation deduction of an asset on which 50% bonus depreciation was claimed. Exempts the subtraction from Section 250.

SECTION 203(d)(2)(P)--BONUS DEPRECIATION DEDUCTION

CREATED BY:

PUBLIC ACT 92-603 - EFFECTIVE: JUNE 28, 2002

An amount equal to the addition modification under subparagraph (D-5) if a taxpayer reports a capital gain or loss based on a sale or transfer of property for which the taxpayer was required to make an addition modification under subparagraph (D-5).

AMENDED BY:

PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

Allows the subtraction of bonus depreciation additions related to an asset that is sold, abandoned or disposed of in any manner during the tax year, or whose depreciable life terminates during the tax year. Exempts the subtraction from Section 250.

SECTION 203(d)(2)(Q)--INTEREST INCOME SUBTRACTION

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, excludes from base income of the taxpayer any interest income whose deduction was disallowed to the payor under the 80-20 interest expense disallowance provisions.

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AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Exempted this subparagraph from automatic sunset under Section 250.

SECTION 203(d)(2)(R)--SUBTRACTION FOR INTEREST FROM AFFILIATED COMPANY

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, excludes from base income of the taxpayer any interest income received from a person who would be a member of the same unitary business group as the taxpayer, not to exceed the amount of interest expense of the taxpayer disallowed as a deduction because paid to the same 80-20 person.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subparagraph to reflect the expansion of the expense disallowance in (D-7).

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Exempted this subparagraph from automatic sunset under Section 250.

SECTION 203(d)(2)(S)--INTANGIBLES INCOME SUBTRACTION

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

For tax years ending on or after December 31, 2004, excludes from base income of the taxpayer any intangibles income whose deduction was disallowed to the payor under the 80-20 intangibles expense disallowance provisions.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subparagraph to reflect the expansion of the expense disallowance in (D-8).

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Exempted this subparagraph from automatic sunset under Section 250.

SECTION 203(d)(2)(T)--SUBTRACTION FOR INSURANCE PAYMENTS

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CREATED BY:

PUBLIC ACT 97-0507- EFFECTIVE: August 23, 2011

Allows an elective subtraction for insured losses when the taxpayer was required to add back the premiums paid for the insurance under subparagraph (D-9).

SECTION 203(d)(2)(FF)--INSURANCE PREMIUM SUBTRACTION - DELETED

CREATED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Added this subparagraph to reflect the disallowance of insurance premium expenses in new subparagraph (D-9).

DELETED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Repealed this subparagraph as unnecessary.

SECTION 203(e)(1)--GROSS INCOME, ADJUSTED GROSS INCOME, TAXABLE INCOME-IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provides that gross income, AGI or taxable income is the amount, which is properly reportable federally.

AMENDED BY:

PUBLIC ACT 77-627 - EFFECTIVE: AUGUST 4, 1977

Added reference to current Section 803(e) relating to farmers.

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Renumbered as Section 203(e).

PUBLIC ACT 83-951 - EFFECTIVE: DECEMBER 1, 1983

Allowed taxable income to be less than zero but not more than the federal net operating loss for the period. Also, if in the year that the federal taxable income is less than zero and the addition modifications exceed the subtraction modifications, an excess addition modification must be reported in the year to which the loss is carried.

PUBLIC ACT 84-1042 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

Provides that the amendments of PA 83-951 apply to tax years ending prior to December 31, 1986.

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PUBLIC ACT 84-1400 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

For tax years ending on or after December 31, 1986, net operating loss carryforwards from tax years ending prior to December 31, 1986, may not exceed the sum of federal taxable income for the taxable year before the NOL deduction, plus the excess of addition modifications over subtraction modifications for the taxable year.

SECTION 203(e)(2)--GROSS INCOME, ADJUSTED GROSS INCOME, TAXABLE INCOME-SPECIAL RULES

SECTION 203(e)(2)(A)--SPECIAL RULES--LIFE INSURANCE COMPANIES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

In the case of life insurance companies, taxable income properly reportable federally is Life Insurance Company Taxable Income.

AMENDED BY:

PUBLIC ACT 85-293 - EFFECTIVE: SEPTEMBER 8, 1987

Changed IRC reference from Section 802 to Section 801.

PUBLIC ACT 86-678 - EFFECTIVE: SEPTEMBER 1, 1989

Added the statement "plus the amount of distribution from pre-1984 policyholder surplus accounts as calculated under Section 815(a) of the Internal Revenue Code."

SECTION 203(e)(2)(B)--SPECIAL RULES--OTHER INSURANCE COMPANIES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided that for mutual insurance companies subject to the provisions of Section 821(a) or (c) of the IRC, taxable income means mutual insurance company taxable income or taxable investment income.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Revised IRC reference from Section 821 to Section 831 and changed reference to mutual insurance company taxable income or taxable investment income to insurance company taxable income.

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SECTION 203(e)(2)(C)--SPECIAL RULES--REGULATED INVESTMENT COMPANIES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided that for regulated investment companies subject to the provisions of IRC Section 852, taxable income means investment company taxable income.

AMENDED BY:

No amendments.

SECTION 203(e)(2)(D)--SPECIAL RULES--REAL ESTATE INVESTMENT TRUSTS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided that for real estate investment trusts subject to the provisions of IRC Section 857, taxable income means real estate investment trust taxable income.

AMENDED BY:

No amendments.

SECTION 203(e)(2)(E)--SPECIAL RULES--CONSOLIDATED CORPORATIONS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided that in the case of a company which is a member of a consolidated group for federal purposes, taxable income should be computed as if the company had filed a separate federal income tax return for the current year and all preceding years and as if the election provided by Section 243(b)(2) of the IRC had been in effect for all such years.

AMENDED BY:

PUBLIC ACT 80-588 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER SEPTEMBER 12, 1977

Revised IRC reference to include, in addition to the election provided in Section 243(b)(2), the election provided in Section 172(b)(2)(E) of the IRC, which relates to the carryback of net operating losses.

PUBLIC ACT 81-1405 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1980

Revised IRC reference from Section 172(b)(2)(E) to Section 172(b)(2)(C).

PUBLIC ACT 84-1042 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

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Deleted reference to IRC Section 172(b)(2)(C) due to creation of Illinois net loss provisions in the IITA.

SECTION 203(e)(2)(F)--SPECIAL RULES--COOPERATIVES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provides that in the case of a cooperative corporation or association, taxable income means income determined in accordance with Sections 1381 through 1388 of the IRC.

AMENDED BY:

PUBLIC ACT 96-0932- EFFECTIVE: JUNE 21, 2010

Allows cooperatives to elect to compute federal taxable income without regard to the limitation on offsetting patronage and nonpatronage losses and income, or to compute their Illinois net losses by tracking patronage and nonpatronage losses separately, the same as federal NOLs.

PUBLIC ACT 97-0033- EFFECTIVE: AUGUST 12, 2011

Changed the reference to Public Act 96-0932.

Public Act 97-0507 made the same amendment.

SECTION 203(e)(2)(G)--SPECIAL RULES--SUBCHAPTER S CORPORATIONS

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Added provisions for computing taxable income in the case of corporations for which there is in effect an election under Section 1372 of the IRC (Subchapter S corporations).

AMENDED BY:

PUBLIC ACT 83-1352 - EFFECTIVE: SEPTEMBER 8, 1984

Essentially rewrote the section relating to the computation of the taxable income of a Subchapter S corporation. If a Section 1362 election is in effect, taxable income is computed in accordance with Section 1363(b) of the IRC except that it also includes the items, which are required to be separately stated under Section 1363(b)(1). If there is in effect an election to opt out of the provisions of the Subchapter S Revision Act of 1982 and the company has applied instead the prior federal Subchapter S rules as in effect on July 1, 1982, taxable income is computed in accordance with the federal Subchapter S rules in effect on July 1, 1982.

SECTION 203(e)(2)(H)--SPECIAL RULES--PARTNERSHIPS

CREATED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

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Provided that in the case of partnerships, taxable income is computed in accordance with Section 703 of the IRC except that it also includes those items which are required by Section 703(a)(1) to be separately stated.

AMENDED BY:

No amendments.

SECTION 203(e)(3)--RECAPTURE OF BUSINESS EXPENSES

CREATED BY:

PUBLIC ACT 83-840 - EFFECTIVE: JULY 30, 2004

Added subsection (e)(3) to provide that, if the taxpayer treated income from an asset or activity as business income and in a subsequent year income from that asset or activity is determined to be nonbusiness income, all deductions related to the income from that activity in the current and two prior years must be recaptured.

SECTION 203(f)--VALUATION LIMITATION AMOUNT

CREATED BY:

PUBLIC ACT 77-669 - EFFECTIVE: TAX YEARS BEGINNING AFTER DECEMBER 31, 1970

Defines the valuation limitation amount, which was allowable as a subtraction for individuals, trusts and estates.

AMENDED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Renumbered as Section 203(f).

PUBLIC ACT 84-1400 - EFFECTIVE: SEPTEMBER 18, 1986

Added the provision that the valuation limitation amount was allowable as a subtraction for partnerships.

SECTION 203(g)--DOUBLE DEDUCTIONS

CREATED BY:

PUBLIC ACT 77-669 - EFFECTIVE: TAX YEARS BEGINNING AFTER DECEMBER 31, 1970

Added section, which states that nothing in Section 203 allows the same item to be deducted twice.

AMENDED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

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Renumbered as Section 203(g).

SECTION 203(h)--LEGISLATIVE INTENTION

CREATED BY:

PUBLIC ACT 77-669 - EFFECTIVE: TAX YEARS BEGINNING AFTER DECEMBER 31, 1970

Added section, which states that no modifications or limitations in determining gross income, AGI or taxable income is allowed unless it is specifically provided for in this section.

AMENDED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Renumbered as Section 203(h).

SECTION 204--STANDARD EXEMPTION

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Allowed a subtraction to all taxpayers equal to $1000 multiplied by a fraction, the numerator of which is the taxpayer's base income allocable to Illinois and the denominator of which is the taxpayer's total base income. For individuals, an additional $1000 is allowed for each exemption in excess of one which is allowed federally.

AMENDED BY:

PUBLIC ACT 86-146 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1990

Made various minor terminology changes. Also added subsection (d) which provides an additional exemption for an individual taxpayer and/or his or her spouse who are 65 years of age or older and/or blind. The subsection contains provisions for individuals that file separate and joint returns and also defines "blindness" for purposes of this section.

PUBLIC ACT 87-880 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1992

Subsection (b) was amended to provide that any taxpayer claimed as a dependent on another person's tax return under the Internal Revenue Code of 1986 shall not be allowed any basic amount under this subsection.

PUBLIC ACT 87-1246 - EFFECTIVE: DECEMBER 24, 1992

Further amended subsection (b) to state that (for tax years ending on or after December 31, 1992) any taxpayer WHOSE ILLINOIS BASE INCOME EXCEEDS $1,000 AND WHO IS claimed as a dependent on another person's tax return under the Internal Revenue Code of 1986 shall not be allowed any basic amount under this subsection.

PUBLIC ACT 90-613 - EFFECTIVE: JULY 9, 1998

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Amended Subsection (b) to increase the basic amount of the standard exemption to $1,300 for taxable years ending on or after December 31, 1998 and prior to December 31, 1999, $1,650 for taxable years ending on or after December 31, 1999 and prior to December 31, 2000 and $2,000 for taxable years ending on or after December 31, 2000. Also, the Act further amends subsection (b) to state that (for tax years ending on or after December 31, 1992) any taxpayer whose Illinois base income exceeds the basic amount and who is claimed as a dependent on another person's tax return under the Internal Revenue Code of 1986 shall not be allowed any basic amount under this subsection. The "Sunset provisions" of Section 250 do not apply to this amendment.

Amended Subsection (c) to increase the additional exemption to be equal to the basic amount for each exemption. Also, the "Sunset provisions" of Section 250 do not apply.

PUBLIC ACT 93-029 - EFFECTIVE: JUNE 20, 2003

Corporations are not allowed any exemption for taxable years ending on or after December 31, 2003.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Deleted extraneous language in reference to the IRC in subsection (b).

PUBLIC ACT 97-0652- EFFECTIVE: JANUARY 10, 2012

Amended Subsection (b) to increase the basic amount of the standard exemption to $2,050 for 2012 and added Subsection (d-5) to index the exemption for inflation in 2013 and beyond.

PUBLIC ACT 100-22 – EFFECTIVE: JULY 6, 2017

Added subsection (g) to provide that no exemption is allowed for any tax year beginning on or after January 1, 2017, to taxpayers with adjusted gross income in excess of $500,000 if married filing joint for federal income tax purposes or $250,000 for all other taxpayers.

PUBLIC ACT 100-865 – EFFECTIVE: AUGUST 14, 2018

Amended subsection (b) to extend the $2,050 exemption amount through 2023.

SECTION 205--EXEMPT ORGANIZATIONS

SECTION 205(a)--CHARITABLE ETC. ORGANIZATIONS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Base income of an organization that is exempt from the federal income tax by reason of Section 501(a) of the IRC should not compute base income in accordance with Section 203 of the IITA. It is taxable on its unrelated business income as computed under Section 512 of the IRC without any deduction allowed for tax imposed by this Act. No Standard Exemption is allowed.

AMENDED BY:

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

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Deleted the reference to “Section 501(a)” of the IRC.

PUBLIC ACT 101-545- EFFECTIVE: AUGUST 23, 2019

Changed definition of base income to exclude excessive executive income from federal unrelated business taxable income.

SECTION 205(b)--PARTNERSHIPS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Partnerships are not subject to tax but must file returns and other information in accordance with Article 5 of the IITA. Partners are liable for tax only in their separate or individual capacities.

AMENDED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Revised the subsection to state that partnerships are liable for Replacement Tax and should compute base income in accordance with Section 203(d) of the IITA. Also states that partners are liable for the Replacement Tax liability of the partnership as provided under the Illinois laws which govern the liability of partners for obligations of partnerships.

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Provides that investment partnerships are exempt from replacement tax in tax years ending on or after December 31, 2004.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Added a redundant sentence stating that investment partnerships are exempt from replacement tax.

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Deleted the redundant sentence on investment partnerships.

SECTION 205(c)--SUBCHAPTER S CORPORATIONS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Subchapter S corporations are not subject to the tax imposed by the IITA but must file returns and other information as required by Article 5.

AMENDED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Revised subsection to state that Subchapter S corporations are subject to Replacement Tax.

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PUBLIC ACT 83-1352 - EFFECTIVE: SEPTEMBER 8, 1984

Substituted "Subchapter S corporation" for "corporation for which there is in effect an election under IRC Section 1362."

SECTION 205(d)--COMBAT ZONE DEATH

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

An individual relieved of federal income tax by reason of Section 692 of the IRC is not subject to the tax imposed by the IITA.

AMENDED BY:

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Amended the title to reflect expansion of Section 692 of the IRC to apply to deaths from terrorist attacks and certain other causes.

SECTION 205(e)--CERTAIN TRUSTS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Common trust funds described in Section 584 of the IRC and any other trust, which is governed by Section 671 through 678 of the IRC, are not subject to the tax imposed by the IITA.

SECTION 205(f)--CERTAIN BUSINESS ACTIVITIES

CREATED BY:

PUBLIC ACT 88-361 - EFFECTIVE: AUGUST 16, 1993

A person who is not otherwise subject to the IITA will not become subject to the IITA by reason of the person owning tangible personal property located at an Illinois printer or by reason of activities of the person's employees or agents located solely at the premises of the Illinois printer performing activities relating to quality control, distribution or printing services.

AMENDED BY:

No amendments.

SECTION 205(g)--NONPROFIT RISK ORGANIZATIONS

CREATED BY:

PUBLIC ACT 93-918 - EFFECTIVE: AUGUST 12, 2004

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Created subsection (g), exempting nonprofit risk organizations from tax.

SECTION 206--COAL RESEARCH/COAL UTILIZATION EQUIPMENT CREDITS

CREATED BY:

PUBLIC ACT 83-1516 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1985

Provided for 2 credits against Income Tax. Subsection (a) allows a credit equal to 20% of the amount donated to the Illinois Center for Research on Sulfur in Coal. Subsection (b) allows for a credit equal to 5% of the amount spent during the year by a corporation on equipment purchased for the purpose of maintaining or increasing the use of Illinois coal in any Illinois facility. Both credits expire January 1, 1995.

AMENDED BY:

PUBLIC ACT 84-1429 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Revised the subsection (b) credit to be used in the year in which the equipment was placed in service. Allowed both credits to be carried forward 5 years to offset any Income Tax liability.

PUBLIC ACT 88-599 - EFFECTIVE: SEPTEMBER 1, 1994

Extends the credits until January 1, 2005.

SECTION 207--NET LOSSES

CREATED BY:

PUBLIC ACT 84-1042 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

Added provisions, which allow for an Illinois net loss in the case of a corporation, trust or estate.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Extended the Illinois net loss provisions to apply to partnerships.

PUBLIC ACT 91-541 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1999

For tax years ending on or after December 31, 1999, Section 207 was amended to decouple from the carryover and carryback provisions of IRC Section 172. For tax years ending on or after December 31, 1999, an Illinois net loss shall be allowed as a carryback to each of the two taxable years preceding the taxable year of such loss and shall be allowed as a carryover to each of the twenty taxable years following the taxable year of such loss.

For tax years ending on or after December 31, 1999, the change to Section 207 eliminates all of the special federal carryback/carryforward provisions (i.e. bad debt losses for commercial banks) that were contained IRC Section 172. The election to forgo the Illinois NLD carryback period remains in effect and must be made by the extended due date.

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PUBLIC ACT 93-29 - EFFECTIVE: JUNE 20, 2003

Losses incurred in taxable years ending on or after December 31, 2003, may only be carried forward for a period of twelve years.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Added new subsection (c) to disallow net losses to the extent income from discharge of indebtedness is excluded from income, and federal net operating losses are reduced, under IRC Section 108.

PUBLIC ACT 96-1496- EFFECTIVE: JANUARY 13, 2011

Added new subsection (d) to suspend net loss deductions for tax years ending after December 31, 2010 and prior to December 31, 2014.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Added new subsection (e) to allow net loss carryover equivalent to federal NOL carryover allowed for residual interest owners of a REMIC, when deductions or losses are disallowed because of the rule that taxable income may not be less than the income derived from the REMIC.

PUBLIC ACT 97-0636- EFFECTIVE: DECEMBER 16, 2011

Amends subsection (d) to change the suspension to a $100,000 cap on the net loss deduction for tax years ending on or after December 31, 2012 and prior to December 31, 2014.

SECTION 208--TAX CREDIT FOR RESIDENTIAL REAL PROPERTY TAXES

CREATED BY:

PUBLIC ACT 87-17 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1991

Allows individual taxpayers a credit equal to 5% of the real property taxes paid on their principal residence.

AMENDED BY:

PUBLIC ACT 100-22 – EFFECTIVE: JULY 6, 2017

Added subsection (g) to provide that no credit is allowed for any tax year beginning on or after January 1, 2017, to taxpayers with adjusted gross income in excess of $500,000 if married filing joint for federal income tax purposes or $250,000 for all other taxpayers.

SECTION 208.1--HOMEOWNERS' TAX RELIEF REBATE

CREATED BY:

PUBLIC ACT 91-703 - EFFECTIVE: MAY 16, 2000

Adds new Section 208.1 which provides that the Department shall pay a rebate to taxpayers in the amount of the Illinois income tax credit allowed under Section 208 with respect to the taxpayer's 1999

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Illinois income tax return for residential real property taxes paid on the principal residence of the taxpayer. The rebate shall not exceed $300 per principal residence.

REPEALED BY:

PUBLIC ACT 100-621 – EFFECTIVE: JULY 20, 2018

SECTION 209--TECH-PREP CREDIT

CREATED BY:

PUBLIC ACT 88-505 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER JUNE 30, 1995

Allows taxpayers that are primarily engaged in manufacturing a credit against their Income Tax liability, equal to 20% of the taxpayer's direct payroll expenses for cooperative secondary school youth vocational programs in Illinois. No expenses can be claimed for this credit and for the Section 201(j) credit. Any credit in excess of the Income Tax liability for the year may be carried forward for 2 years.

AMENDED BY:

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

Amends the TECH-PREP credit to include personal services rendered to the taxpayer by a TECH-PREP student or instructor: 1) Which would be subject to the withholding provision of the IITA if the student or instructor was an employee of the taxpayer, and 2) For which no TECH-PREP credit is claimed by another taxpayer.

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Removes the wording “and the Department of Revenue”.

SECTION 210--DEPENDENT CARE PROGRAM CREDIT

CREATED BY:

PUBLIC ACT 88-505 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER JUNE 30, 1995

Allows taxpayers who are primarily engaged in manufacturing to claim a credit against their Income Tax liability equal to 5% of the expenses for providing in the Illinois premises of the taxpayer's workplace an on-site facility dependent care assistance program under Section 129 of the IRC. Any excess credit may be carried forward for 2 taxable years.

AMENDED BY:

No amendments.

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SECTION 210.5--EMPLOYEE CHILD CARE TAX CREDIT

CREATED BY:

PUBLIC ACT 91-930 - EFFECTIVE: TAX YEARS BEGINNING ON OR AFTER DECEMBER 31, 2000

Creates the Employee Child Care Tax Credit against the regular income tax obligation of corporations. The credit is 30% of start-up costs plus 5% of operating expenses incurred during the tax year to provide a child care facility for dependents of employees of the corporation. The 30% credit is allowed only for tax years ending on or before December 31, 2004. The 5% credit has no sunset date and is exempt from Section 250.

AMENDED BY:

PUBLIC ACT 95-648 - EFFECTIVE: AUGUST 22, 2007

Amended this subparagraph to re-instate the 30% credit for taxable years ending on or after December 31, 2007, and to exempt the credit from automatic sunset under Section 250.

SECTION 211--ECONOMIC DEVELOPMENT FOR A GROWING ECONOMY TAX CREDIT

CREATED BY:

PUBLIC ACT 91-476 - EFFECTIVE: TAX YEARS BEGINNING ON OR AFTER JANUARY 1, 1999

Creates the Economic Development for a Growing Economy ("EDGE) tax credit. A taxpayer who has entered into an Agreement under the Economic Development for a Growing Economy Tax Credit Act is entitled to a credit against the taxes imposed under subsections (a) and (b) of Section 201 of this Act in an amount to be determined in the Agreement. If the taxpayer is a partnership or Subchapter S corporation, the credit shall be allowed to the partners or shareholders in accordance with the determination of income and distributive share of income under Sections 702 and 704 and subchapter S of the IRC.

The economic EDGE credit is subject to the conditions of the agreement reached between the Department of Commerce and Community Affairs (DCCA) and the taxpayer. In addition, the credit is subject to the limitations imposed by Section 211 of the IITA.

AMENDED BY:

PUBLIC ACT 92-207 - EFFECTIVE: AUGUST 1, 2001

Allows EDGE credits awarded under the Corporate Headquarters Relocation Act to be claimed over a period of up to 15 years, rather than the 10 year-period allowed for other EDGE credits.

PUBLIC ACT 101-9 - EFFECTIVE: JUNE 5, 2019

Added references to EDGE New Construction credits.

SECTION 212--EARNED INCOME TAX CREDIT

CREATED BY:

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PUBLIC ACT 91-700 - EFFECTIVE: MAY 11, 2000

Creates the earned income tax credit. Each individual taxpayer is entitled to a credit against the tax imposed by the Act in an amount equal to 5% of the federal tax credit for each taxable year beginning on or after January 1, 2000 and ending on or before December 31, 2002.

AMENDED BY:

PUBLIC ACT 93-534 - EFFECTIVE: AUGUST 18, 2003

For tax years beginning on or after January 1, 2003, TANF-eligible taxpayers may receive a refundable credit under this section.

PUBLIC ACT 95-333 - EFFECTIVE: AUGUST 21, 2007

Amended this subparagraph to make the credit refundable for all taxpayers.

PUBLIC ACT 97-0652- EFFECTIVE JANUARY 10, 2012

Increases the credit to 7.5% of the federal credit for 2012 and to 10% of the federal credit after 2012.

PUBLIC ACT 100-22 – EFFECTIVE: JULY 6, 2017

Increased the credit to 14% of the federal credit for calendar 2017 and to 18% for taxable years beginning on or after January 1, 2017.

SECTION 213--FILM PRODUCTION SERVICES CREDIT

CREATED BY:

PUBLIC ACT 93-543 - EFFECTIVE: AUGUST 18, 2003

Creates the credit for film production services expenses incurred in Illinois for taxable years beginning on or after January 1, 2004.

AMENDED BY:

PUBLIC ACT 94-171 - EFFECTIVE: JULY 11, 2005

Makes the credit transferable and allows excess credits to be carried forward 5 years. Changes reference from DCCA to DCEO.

PUBLIC ACT 95-720 - EFFECTIVE: MAY 27, 2008

Amends the section to refer to the Film Production Services Tax Credit Act of 2008.

SECTION 214--TAX CREDIT FOR AFFORDABLE HOUSING DONATIONS

CREATED BY:

PUBLIC ACT 92-491 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 2001

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Creates the credit for affordable housing donations. The credit is awarded by the Housing Development Authority, and is equal to 50% of qualifying donations to a low-income housing project. The credit may be transferred to a purchaser of the project or to another party that has made a $10,000 minimum donation to the project. The credit is allowed for tax years ending on or after December 31, 2001 and on or before December 31, 2006.

AMENDED BY:

PUBLIC ACT 93-369 - EFFECTIVE: JULY 24, 2003

Clarifies that the credit may be earned and transferred by a tax-exempt organization and makes other nonsubstantive changes.

PUBLIC ACT 94-46 - EFFECTIVE: JUNE 17, 2005

Extends the sunset date for the credit from December 31, 2006 to December 31, 2011.

PUBLIC ACT 96-1276 - EFFECTIVE: JULY 26, 2010

Extends the sunset date for the credit from December 31, 2011 to December 31, 2016.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Added a missing “to” to subsection (a).

PUBLIC ACT 99-0915- EFFECTIVE: DECEMBER 20, 2016

Extends the sunset date for the credit from December 31, 2016 to December 31, 2021.

SECTION 215--TRANSPORTATION EMPLOYEE CREDIT - DELETED

CREATED BY:

PUBLIC ACT 93-23 - EFFECTIVE: JUNE 20, 2003

Creates the credit for trucking companies subject to the expanded commercial distribution fee for tax years beginning on or after January 1, 2004.

DELETED BY:

PUBLIC ACT 93-1033 - EFFECTIVE: JULY 1, 2004

SECTION 216--TAX CREDIT FOR HIRING EX-FELONS

CREATED BY:

PUBLIC ACT 94-1067 - EFFECTIVE: AUGUST 1, 2006

Creates the credit for employers who hire qualifying ex-felons.

AMENDED BY:

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PUBLIC ACT 98-165 – EFFECTIVE: AUGUST 5, 2013

Increased the cap on the credit in (a) from $600 to $1500, added the definition of qualifying ex-felon in (c)(1) to replace a cross-reference to “eligible offender” under the Unified Code of Corrections, extended the time since release in (c)(3) from 1 to 3 years, and exempted the credit from automatic sunset.

SECTION 217--TAX CREDIT FOR HIRING VETERANS

CREATED BY:

PUBLIC ACT 94-1067 - EFFECTIVE: AUGUST 1, 2006

Creates the credit for employers who hire qualifying veterans.

AMENDED BY:

PUBLIC ACT 96-101 - EFFECTIVE: JULY 27, 2009

Increased the credit from 5% of wages, with a cap of $600 per employee 10% of wages, with a cap of $1200 per employee, for tax years beginning on or after January 1, 2010.

PUBLIC ACT 97-767 – EFFECTIVE: JULY 9, 2012

Added subsection (d) to prohibit this credit if the credit under Section 217.1 is claimed.

SECTION 217.1--TAX CREDIT FOR HIRING UNEMPLOYED VETERANS

CREATED BY:

PUBLIC ACT 97-767 – EFFECTIVE: JULY 9, 2012

Creates the credit for employers who hire qualified unemployed veterans.

SECTION 218--TAX CREDIT FOR EMPLOYER CONTRIBUTIONS TO SECTION 529 PLANS

CREATED BY:

PUBLIC ACT 96-198 - EFFECTIVE: AUGUST 10, 2009

Allows a credit to employers for contributions to Section 529 plans for tax years ending on or after December 31, 2009, and prior to December 31, 2020.

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SECTION 219--TAX CREDIT FOR HISTORIC PRESERVATION EXPENDITURES

CREATED BY:

PUBLIC ACT 96-0933 - EFFECTIVE: JUNE 21, 2010

Allows a credit to for expenditures qualifying for the federal historic preservation credit for a hotel in Peoria.

SECTION 220--ANGEL INVESTMENT CREDIT

CREATED BY:

PUBLIC ACT 96-0939 - EFFECTIVE: JUNE 24, 2010

Allows a credit for investments in start-up businesses certified by DCEO.

AMENDED BY:

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Corrected reference to “a applicant” in subsection (a).

PUBLIC ACT 97-1097- EFFECTIVE: AUGUST 24, 2012

Adds provision in subsection (b) that requires the business to be certified before an investment qualifying for the credit may be made and rewords the qualification provisions in subjection (e) to clarify them.

PUBLIC ACT 100-328 – EFFECTIVE: JANUARY 1, 2018

Extends the credit through taxable years ending on or before December 31, 2021. Makes numerous changes to the criteria for earning the credit administered by DCEO and adds a recapture provision when the venture fails to maintain the minimum employment threshold.

PUBLIC ACT 100-587 – EFFECTIVE: JUNE 4, 2019

Makes changes to the provisions dealing with the reservation of credits for businesses owned by minorities, women or disabled persons.

PUBLIC ACT 100-686 – EFFECTIVE: JANUARY 1, 2019

Makes changes to the definitions of qualifying businesses and related parties, and with the provisions dealing with the reservation of credits for businesses owned by minorities, women or disabled persons and adds provisions dealing with the reservation of credits for businesses in counties with populations of 250,000 or less.

PUBLIC ACT 101-81 – EFFECTIVE: JULY 12, 2019

Changed references to “female-owned” businesses to refer to “women-owned”.

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SECTION 221--RIVER EDGE REDEVELOPMENT ZONE HISTORIC REHABILITATION CREDIT

CREATED BY:

PUBLIC ACT 97-0203-EFFECTIVE: JULY 28, 2011

Allows a credit for costs to rehabilitate historic buildings in River Edge Redevelopment Zones.

AMENDED BY:

PUBLIC ACT 99-0914- EFFECTIVE: DECEMBER 20, 2016

Extends the sunset date for the credit from January 1, 2017, to January 1, 2018.

PUBLIC ACT 100-236 – EFFECTIVE: AUGUST 18, 2017

Extends the sunset date to January 1, 2022.

PUBLIC ACT 100-629- EFFECTIVE: JANUARY 1, 2019

Makes extensive changes to the credit for tax years beginning on or after January 1, 2018, and provides that the credit cannot be earned in tax years beginning on or after January 1, 2022.

PUBLIC ACT 100-695 – EFFECTIVE: AUGUST 3, 2018

Amended the section to reflect the change in administrative responsibility for the credit from the Historic Preservation Agency to the Department of Natural Resources.

PUBLIC ACT 101-9 – EFFECTIVE: JUNE 5, 2019

Added subsection (a-2) references to new River Edge Redevelopment rehabilitation credit, corrected typographical errors and amended references to public acts.

SECTION 222--LIVE THEATER PRODUCTION CREDIT

CREATED BY:

PUBLIC ACT 97-0636-EFFECTIVE: DECEMBER 16, 2011

Creates a credit administered by DCEO for costs of producing plays at a qualifying Illinois theater.

AMENDED BY:

PUBLIC ACT 100-415 – EFFECTIVE: JANUARY 1, 2018

Disallows the credit for taxable years beginning on or after January 1, 2022.

SECTION 223--HOSPITAL CREDIT

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CREATED BY:

PUBLIC ACT 97-688- EFFECTIVE: JUNE 14, 2012

Creates the credit for for-profit hospitals providing charity care.

AMENDED BY:

PUBLIC ACT 100-587 – EFFECTIVE: JUNE 4, 2018

Disallows the credit for tax years ending after December 31, 2022.

SECTION 224—INVEST IN KIDS CREDIT

CREATED BY:

PUBLIC ACT 100-465- EFFECTIVE: AUGUST 31, 2017

Creates the credit for contributions to qualifying scholarship funds.

SECTION 225—INSTRUCTIONAL MATERIALS AND SUPPLIES CREDIT

CREATED BY:

PUBLIC ACT 100-22- EFFECTIVE: JULY 6, 2017

Creates the credit for teachers' expenses for instruction materials and supplies.

SECTION 226—NATURAL DISASTER CREDIT

CREATED BY:

PUBLIC ACT 100-555- EFFECTIVE: NOVEMBER 16, 2017

Creates the credit for real property losses resulting from natural disasters during 2017.

AMENDED BY:

PUBLIC ACT 100-587 – EFFECTIVE: JUNE 4, 2018

Allows the credit for natural disasters during 2018.

PUBLIC ACT 100-731 – EFFECTIVE: JANUARY 1, 2019

Added subsection (g) to permit information sharing by local governments with regard to this credit.

SECTION 227—ADOPTION CREDIT

CREATED BY:

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PUBLIC ACT 100-587- EFFECTIVE: JUNE 4, 2018

Creates the adoption credit for tax years ending on or after December 31, 2018.

SECTION 228—HISTORIC PRESERVATION CREDIT

CREATED BY:

PUBLIC ACT 100-629- EFFECTIVE: JANUARY 1, 2019

Creates a new historic preservation credit for tax years beginning on or after January 1, 2019, as Section 227.

AMENDED BY:

PUBLIC ACT 101-81- EFFECTIVE: JULY 12, 2019

Changed to Section 228.

SECTION 229—DATA CENTER CREDIT

CREATED BY:

PUBLIC ACT 101-31 - EFFECTIVE: JUNE 28, 2019

Creates a new data center credit.

AMENDED BY:

PUBLIC ACT 101-604- EFFECTIVE: DECEMBER 13, 2019

Changed references to census data source.

SECTION 229—APPRENTICESHIP EDUCATION CREDIT

CREATED BY:

PUBLIC ACT 101-207 - EFFECTIVE: AUGUST 2, 2019

Creates a new apprenticeship education credit.

SECTION 245--DO-IT-YOURSELF SCHOOL FUNDING

CREATED BY:

PUBLIC ACT 90-553 - EFFECTIVE: JUNE 1, 1998

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Allows taxpayers to elect to forego the property tax credit (Section 208) or the exemptions allowed (Section 204) and instead direct that additional amount of tax into the Do-It-Yourself School Funding Fund for tax years ending on or after December 31, 1998 and before December 31, 2000.

DELETED BY:

PUBLIC ACT 99-0933- EFFECTIVE: January 27, 2017

SECTION 250--SUNSET PROVISIONS

CREATED BY:

PUBLIC ACT 88-660 - EFFECTIVE: SEPTEMBER 16, 1994

Provides that every exemption, credit and deduction against tax that becomes law after September 16, 1994 shall be limited by a reasonable and appropriate sunset date. If a reasonable and appropriate sunset date is not specified in the Public Act creating the exemption, credit or deduction, the exemption, credit or deduction will automatically expire for tax years beginning on or after 5 years after the effective date of the Public Act creating the exemption, credit or deduction.

AMENDED BY:

PUBLIC ACT 89-460 - EFFECTIVE: DECLARATORY OF EXISTING LAW

The sunset provisions do not terminate the tax-exempt status of an obligation-ruled exempt by state statute until the issuer has paid the obligation.

PUBLIC ACT 97-0636-EFFECTIVE: DECEMBER 16, 2011

Adds subsection (b) to provide that credits sunsetting in 2011, 2012 or 2013 are extended an additional 5 years.

SECTION 301--ALLOCATION/APPORTIONMENT OF BASE INCOME-GEN.

SECTION 301(a)--RESIDENTS

CREATED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Provided that residents allocate all items of income or deduction, which were taken into account in the computation of base income to Illinois.

AMENDED BY:

No amendments.

SECTION 301(b)--PART-YEAR RESIDENTS

CREATED BY:

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PUBLIC ACT 77-2292 - EFFECTIVE: TAX YEARS BEGINNING AFTER DECEMBER 31, 1970

Provided that part-year residents should allocate to Illinois all items of income or deduction taken into account in the computation of base income for that part of the year for which the person was a resident of Illinois. The remaining items should be allocated to Illinois in accordance with Sections 302, 303 or 304.

AMENDED BY:

No amendments.

SECTION 301(c)--OTHER PERSONS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided that any item of income or deduction taken into account in the computation of base income and which is referred to in Sections 302, 303 or 304 should be allocated to Illinois only to the extent provided by such section. Unspecified items included in base income are allocated to Illinois in the case of an individual, trust or estate, if it is a resident of Illinois. In the case of corporations, the unspecified items are allocated to the state of commercial domicile at the time the item was paid, incurred or accrued. (This was the original Section 301.)

AMENDED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Added references to "any person other than a resident" and rewrote subsection (b) regarding unspecified items to relate only to nonresidents.

PUBLIC ACT 82-609 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER JANUARY 1, 1982

Provided for the allocation of unspecified items of income of a partnership to be allocated to Illinois if it was the state of commercial domicile at the time the item was paid, incurred or accrued.

PUBLIC ACT 90-491 - EFFECTIVE: JANUARY 1, 1998

Moves the allocation rules for unspecified income of nonresident trusts from subsection (a) where it was not allocated to Illinois, to subsection (B) where it is allocated to Illinois if the commercial domicile is in Illinois when the income was received or incurred.

PUBLIC ACT 90-562 - EFFECTIVE: IMMEDIATELY

Reverses the amendments made by PA 90-491.

SECTION 302--COMPENSATION PAID TO NONRESIDENTS

SECTION 302(a)--RESIDENTS--DELETED

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CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided that all compensation paid to a resident and all deductions directly related thereto should be allocated to Illinois.

DELETED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

SECTION 302(a)--NONRESIDENTS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided that all items of income (and the deductions directly allocable thereto) that are paid in this state to a nonresident are allocable to Illinois.

AMENDED BY:

No amendments.

SECTION 302(b)--RECIPROCAL EXEMPTION

CREATED BY:

PUBLIC ACT 76-2404 - EFFECTIVE: JUNE 29, 1970

If the Director enters into a written agreement with any state which imposes a tax on or measured by net income to provide that compensation paid in such state to residents of Illinois shall be exempt from the tax in such state, any compensation paid in Illinois to a resident of such state shall not be allocated to Illinois.

AMENDED BY:

PUBLIC ACT 90-491 - EFFECTIVE: January 1, 1998

All reciprocal agreements are subject to the requirements of Section 39b53 of the Civil Administrative Code of Illinois.

SECTION 302(c)--CROSS REFERENCES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The allocation of amounts received by certain employee trusts is discussed in Section 301(b)(2).

AMENDED BY:

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PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Added references to Section 301(a) for allocation rules if a resident is involved.

SECTION 303--NONBUSINESS INCOME OF NONRESIDENTS

SECTION 303(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any item of nonbusiness income and any deduction directly allocated thereto should be allocated to Illinois in accordance with this section.

AMENDED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Added references to nonresidents.

PUBLIC ACT 79-743 - EFFECTIVE: SEPTEMBER 4, 1975

Added references to the Illinois Lottery Law.

PUBLIC ACT 101-31 - EFFECTIVE: JUNE 28, 2019

Added references to gaming and horse racing in (c-1).

SECTION 303(b)--CAPITAL GAINS AND LOSSES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided for allocation rules for capital gains and losses from the sale of real, tangible personal and intangible property.

AMENDED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Deleted references to residents.

SECTION 303(c)--RENTS AND ROYALTIES

CREATED BY:

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PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided for allocation rules for rents and royalties from real, tangible personal and intangible property.

AMENDED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Deleted references to residents.

SECTION 303(c-1)--WAGERING AND GAMBLING WINNINGS

CREATED BY:

PUBLIC ACT 101-31 - EFFECTIVE: JUNE 28, 2019

Allocates nonbusiness winnings from Illinois horse tracks and casinos to Illinois.

SECTION 303(d)--PATENT AND COPYRIGHT ROYALTIES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided for allocation rules for royalties from copyrights and patents.

AMENDED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Deleted references to residents.

SECTION 303(e)--ILLINOIS LOTTERY PRIZES

CREATED BY:

PUBLIC ACT 79-743 - EFFECTIVE: SEPTEMBER 4, 1975

Prizes awarded under the Illinois Lottery Law are allocable to Illinois.

AMENDED BY:

PUBLIC ACT 98-496 – EFFECTIVE: AUGUST 16, 2013

Provides that gains from assignments of lottery winnings are sourced to Illinois in tax years ending on or after December 31, 2013.

SECTION 303(e-5)--UNEMPLOYMENT BENEFITS

CREATED BY:

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PUBLIC ACT 97-709- EFFECTIVE: June 25, 2012

Provides that unemployment benefits paid by Illinois are allocated to Illinois.

SECTION 303(f)--TAXABILITY IN OTHER STATE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provides the rules for determining if a taxpayer is taxable in another state.

AMENDED BY:

No amendments.

SECTION 303(g)--CROSS REFERENCES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Allocation of interest and dividends is discussed in Section 301(b)(2).

AMENDED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Added references to nonresidents. Allocation of nonbusiness income of residents is discussed in Section 301(a).

SECTION 304--BUSINESS INCOME OF NONRESIDENTS

SECTION 304(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided that every person that derives business income from Illinois and one or more other states will apportion business income pursuant to Section 304. Except for business income of insurance companies, financial organizations and from furnishing transportation services, all business income will be apportioned using a 3-factor formula consisting of property, payroll and sales factors.

AMENDED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

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Essentially rewrote Section 304(a) to state that if the business income of a person (other than a resident) is derived wholly within Illinois, all of the income is allocated to Illinois. If the business income is derived from sources within Illinois and one or more other states, a 3-factor formula consisting of property, payroll and sales factors is used except as otherwise provided in this section.

PUBLIC ACT 84-1382 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1987

Changed the 3-factor apportionment formula to double-weight the sales factor. The property, payroll and twice the sales factor are added and the sum is divided by 4.

PUBLIC ACT 90-613 – EFFECTIVE: JULY 9, 1998

Changed the apportionment formula for years ending on or after December 31, 1998 to a single factor sales apportionment formula as detailed in Section 304(h).

SECTION 304(a)(1)--PROPERTY FACTOR

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provides for the computation of the property factor.

AMENDED BY:

No amendments.

SECTION 304(a)(2)--PAYROLL FACTOR

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provides for the computation of the payroll factor.

AMENDED BY:

PUBLIC ACT 87-880 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1992

For purposes of determining whether an individual's service is performed entirely within Illinois, any resident of a state that imposes a comparable tax liability on Illinois residents who is performing a personal service under a personal service contract for a sports performance at a sporting event which is taking place in Illinois shall be considered to be performing a service entirely in Illinois.

PUBLIC ACT 94-247 - EFFECTIVE: JANUARY 1, 2006.

Amends the professional athlete provision to allow all nonresidents to use duty-days and to provide guidance for computations.

PUBLIC ACT 101-585 - EFFECTIVE: AUGUST 26, 2019.

Added “working days” provisions for wages paid for services performed both within and without Illinois.

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SECTION 304(a)(3)--SALES FACTOR

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provides for the computation of the sales factor.

AMENDED BY:

PUBLIC ACT 81-478 - EFFECTIVE: SEPTEMBER 7, 1979

Added the statement to Section 304(a)(3)(B)(ii) that premises owned or leased by a person who has independently contracted with the seller for the printing of newspapers, periodicals or books shall not be deemed to be an office, store, warehouse, factory or other place of storage for purposes of the sales factor.

PUBLIC ACT 82-1029 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1982

Added provision to Section 304(a)(3)(B)(ii) that states that sales of tangible personal property are not in Illinois if the seller and purchaser would be members of the same UBG but for the fact that either the seller or purchaser is a person with 80% or more of total business activity outside of the United States and the property is purchased for resale.

PUBLIC ACT 89-379 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1995 AND ENDING BEFORE JANUARY 1, 1998.

Amends Section 304(a)(3)(D) for tax years ending on or after December 31, 1995 and ending before January 1, 1998 to state that the following items of income shall not be included in the numerator or denominator of the sales factor:

1) Dividends
2) Section 78 Gross-Up
3) Subpart F income

The amendment further states, "No inference shall be drawn for the enactment of this paragraph in construing this Section for taxable years ending before December 31, 1995.

PUBLIC ACT 90-562 - EFFECTIVE: IMMEDIATELY

Eliminates the sunset provision of Public Act 89-379. Dividends, Section 78 Gross-up and Subpart F income will not be included in the numerator or denominator of the sales factor.

PUBLIC ACT 91-541 - EFFECTIVE: FOR TAX YEARS BEGINNING ON OR AFTER DECEMBER 31, 1999.

Section 304(a)(3) was amended to change the manner in which income from patents, copyrights, trademarks, and similar items of intangible personal property are treated in the sales factor.

The Act defines the treatment of royalties in the sales factor. Specifically, the bill provides that income from the sale, license, or other disposition of patents, copyrights, trademarks, and similar intangible assets will be excluded from the numerator and the denominator of the sales factor unless that income comprises more than 50% of the taxpayer's income over a 3 year period. Further, if this income is included in the sales factor, it will be sourced to the state in which the licensee or purchaser utilizes the patents, copyrights, trademarks, etc.

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A provision has been included in the Act to allow a taxpayer to make an irrevocable election to apply the provisions of the Act for all tax years ending prior to December 31, 1999. No refund shall be payable for tax years ending prior to December 31, 1999 to the extent such refund is the result of applying the provisions of the Act. However, a taxpayer making a valid election can apply it to audits in progress and unagreed audits waiting for a Notice of Deficiency to be issued.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Added new subparagraph (C-5) for taxable years ending on or after December 31, 2008, replacing the income-producing activity test with provisions stating that sales of real property and leases of real or tangible personal property are in the state where the property is located, and that sales of intangible assets and services are sourced to the state in which the benefit is received by the customer.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Added new subparagraph (B-5) to provide special sales factor rules for telecommunications income and amended subparagraph (C-5)(iii) to provide that sales of intangible personal property by dealers are source to the state of the customer and that other taxpayers use the income-producing activity test, allocating the sale to the state in which the majority of costs of performance are incurred, and (C-5)(iv) to source sales of service to the place of receipt, and to provide special rules for determining the place of receipt.

PUBLIC ACT 96-763 - EFFECTIVE: AUGUST 25, 2009

Adds subparagraph (B-7) to provide special sales factor provisions for broadcasting for tax years ending on or after December 31, 2008.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Corrected (3)(B-5)(i) to refer to the “following” terms rather than “follow”.

PUBLIC ACT 98-496 - EFFECTIVE: AUGUST 16, 2013

Added subparagraph (B-8) to source lottery winnings to Illinois in taxable years ending on or after December 31, 2013.

PUBLIC ACT 99-0642- EFFECTIVE: JULY 28, 2016

Corrects a typographical error in a cross reference in subparagraph (B-8).

PUBLIC ACT 100-201 - EFFECTIVE: AUGUST 18, 2017

Corrects a typographical error in a cross reference in subparagraph (B-5)(i).

PUBLIC ACT 101-31 - EFFECTIVE: JUNE 28, 2019

Added subparagraph (B-9) sourcing business winnings from Illinois horse tracks and casinos to Illinois.

SECTION 304(b)--INSURANCE COMPANIES

CREATED BY:

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PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided a special apportionment formula for insurance companies based on a fraction, the numerator of which was the net premiums written on property or risk in Illinois and the denominator of which was the total net premiums written. The term "net premiums" was also defined.

AMENDED BY:

PUBLIC ACT 76-2406 - EFFECTIVE: JANUARY 1, 1971

Rewrote Section 304(b)(1) to base the apportionment formula on direct premiums written rather than net premiums written. The term "direct premiums written" was also defined.

Section 304(b)(2) was added to provide a special apportionment formula for reinsurance companies (companies whose principal source of premiums consists of premiums for reinsurance accepted by it).

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subsection to terminate reinsurance companies' right to elect one of three separate methods to source reinsurance premiums. The election can be made only for tax years ending prior to December 31, 2008.

PUBLIC ACT 97-0507-EFFECTIVE: AUGUST 23, 2011

Amended this subsection to restore the right of reinsurance companies to elect one of three separate methods to source reinsurance premiums, but requires the election to remain binding for future years.

SECTION 304(c)--FINANCIAL ORGANIZATIONS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided a special apportionment formula for financial organizations based on a fraction, the numerator of which is the business income from sources within Illinois and the denominator of which is the total business income. Business income of a financial organization from sources within Illinois is then discussed.

AMENDED BY:

PUBLIC ACT 82-661 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1980

Added provisions in Section 304(c)(2) for an International Banking Facility when computing the financial organization special apportionment formula.

PUBLIC ACT 87-478 - EFFECTIVE: JANUARY 1, 1992

Amended subsection (C) to state that, for purposes of the financial organization apportionment formula, business income in this State will include interest from ILLINOIS CUSTOMERS, WHICH ARE RECEIVED WITHIN ILLINOIS.

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PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subsection to add new paragraph (3), providing a new apportionment formula for taxable years ending on or after December 31, 2008.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Amended new paragraph (3) to delete the provision requiring use of a separate formula to apportion non-financial income, to adopt the new provisions for sourcing sales of service per the amendments to subsection (a)(2)(C-5) and to replace the rule sourcing investment income according to deposits from P.A, 95-233 with a provision adapted from the MTC model regulation's sales factor computation for financial organizations.

SECTION 304(c-1)--FEDERALLY REGULATED EXCHANGES

CREATED BY:

PUBLIC ACT 97-0636-EFFECTIVE: DECEMBER 16, 2011

Creates a new apportionment factor for federally -regulated exchanges for tax years ending on or after December 31, 2012.

SECTION 304(d)--TRANSPORTATION SERVICES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided a special apportionment formula for persons furnishing transportation services based on a fraction, the numerator of which is the revenue miles of the person in Illinois and the denominator of which is the total revenue miles.

AMENDED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subsection to add new paragraphs (3) and (4), providing a new apportionment formula for taxable years ending on or after December 31, 2008. The formula for airlines is based on arrivals and departures in Illinois and everywhere, weighted by the value of the aircraft. For all others, the numerator is comprised of receipts from transactions purely within Illinois plus receipts from other transactions apportioned using an unweighted miles traveled formula.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Amended new paragraphs (3) and (4) to delete the provision requiring the use of a separate formula to apportion non-transportation income, to allow airlines to continue to use the old revenue-miles formula and to require other taxpayers to compute separate fractions for passenger and cargo transportation, and to compute an average of those fractions weighted by relative gross receipts.

SECTION 304(e)--COMBINED APPORTIONMENT

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CREATED BY:

PUBLIC ACT 82-1029 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1982

Provided a special apportionment formula for businesses involved in a unitary business with one or more members of the group conducting business activities in Illinois.

AMENDED BY:

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

Amendment refers to the proper subsection of 1501 for the definition of a unitary business group.

SECTION 304(f)--ALTERNATIVE ALLOCATION

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided for alternative allocation if the statutory apportionment formula did not properly reflect the person's business activities in Illinois.

AMENDED BY:

PUBLIC ACT 90-613 - EFFECTIVE: JULY 9, 1998

Provided for alternative allocation if Section 304(h), single factor sales apportionment formula, did not properly reflect the person's business activities in Illinois.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Provides that the Director may permit or require an adjustment under this subsection without the filing of a petition.

PUBLIC ACT 98-478 - EFFECTIVE: AUGUST 16, 2013

Provides that, for tax years ending on or after December 31, 2008, alternative apportionment may be allowed or required if the statutory formula does not reflect the taxpayer’s market in Illinois.

SECTION 304(g)--CROSS REFERENCES

CREATED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Added a cross-reference to Section 301(a) for information regarding the allocation of business income of residents.

SECTION 304(h)--SINGLE FACTOR SALES APPORTIONMENT FORMULA

CREATED BY:

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PUBLIC ACT 90-613 - EFFECTIVE: JULY 9, 1998

For tax years ending on or after December 31, 1998 through December 30, 1999, the apportionment formula will be equal to 162/3% of the property factor plus 16 2/3% of payroll factor plus 66 2/3% of the sales factor.

For tax years ending on or after December 31, 1999 through December 30, 2000, the apportionment formula will be equal to 8 1/3% of the property factor plus 8 1/3% of payroll factor plus 83 1/3% of the sales factor.

For tax years ending on or after December 31, 2000, the apportionment formula will be the sales factor.

If, in any tax year ending on or after December 31, 1998 and before December 31, 2000, the denominator of the payroll, property or sales factor is zero, the apportionment formula computed in paragraphs (1) or (2) of Section 304(h) for that year shall be divided by an amount equal to 100% minus the percentage weight given to each factor whose denominator is equal to zero.

SECTION 305--ALLOCATION OF PARTNERSHIP INCOME

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided allocation rules for partnership business and nonbusiness income. The Illinois base income of the partnership is the sum of the Illinois business income and the aggregate of the Illinois nonbusiness income of the partners.

AMENDED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Rewrote section to refer to the allocation of partnership income by partnership and partners other than residents. Also added references to apportionment of income in addition to allocation of income. Added Section 305(d), which is a cross-reference to Section 301(a) for allocation of partnership income or deductions by residents.

PUBLIC ACT 81-1405 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1980

Revised Section 305(c) to refer to base income of a partnership rather than business income of the partnership.

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Added subsection (c-5) providing special rules for allocation and apportionment of income from an investment partnership.

SECTION 306--ALLOCATION/APPORTIONMENT OF INCOME--ESTATES/TRUSTS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

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This section contains the provisions for allocating or apportioning income by estates and trusts.

AMENDED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Revised the section to state that base income should be allocated OR APPORTIONED to Illinois.

SECTION 307--ALLOCATION OF INCOME BY ESTATE/TRUST BENEFICIARIES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the provisions for allocating the income by estate or trust beneficiaries.

AMENDED BY:

PUBLIC ACT 76-2402 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1970

Rewrote section to refer to nonresidents only. Also added a provision in Section 307(c) relating to capital gain distributions and referencing Section 669 of the IRC in addition to Section 668. Finally, the Public Act added a cross-reference in Section 307(d) for the allocation of estate or trust income or deductions by residents.

SECTION 308--ALLOCATION OF SUBCHAPTER S CORPORATION INCOME

CREATED BY:

PUBLIC ACT 83-1352 - EFFECTIVE: SEPTEMBER 8, 1984

This section contains the provisions for allocating Subchapter S corporation income by Subchapter S corporations and shareholders other than residents.

AMENDED BY:

No amendments.

SECTION 401--TAXABLE YEAR

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided that in general a person's taxable year for Illinois purposes is the same as the taxable year for federal purposes. If the year is changed federally, it is similarly changed for Illinois purposes. If the year is less than 12 months in length, the Section 204 Standard Exemption is prorated accordingly.

AMENDED BY:

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No amendments.

SECTION 402--METHODS OF ACCOUNTING

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided that in general a person's method of accounting for Illinois purposes is the same as the method of accounting for federal purposes. If the method is changed federally, it is similarly changed for Illinois purposes.

AMENDED BY:

No amendments.

SECTION 403--EFFECT OF FEDERAL DETERMINATION

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided that all items of income, deduction or exclusion reflected on the federal return will be reflected on the Illinois return in the same manner, to the extent not inconsistent with the Act, or forms or regulations of the Department.

AMENDED BY:

PUBLIC ACT 81-1405 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1980

Deleted the phrase "prima facie" before correct in Section 403(b).

SECTION 404—REALLOCATION OF ITEMS

SECTION 404(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Provided for any item of income or deduction, which is inaccurately or improperly reflected in Illinois base income to be reallocated to correct the problem.

AMENDED BY:

No amendments.

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SECTION 404(b)—RESTRICTIONS ON ADJUSTMENTS

CREATED BY:

PUBLIC ACT 95-948 – EFFECTIVE AUGUST 29, 2008

This Act adds that the Director may not make an adjustment to base income under this Section that has the same effect as retroactively applying any amendments to this Act made by Public Act 93-840, Public Act 95-233, or Public Act 95-707.

SECTION 405--CARRYOVERS IN CERTAIN ACQUISITIONS

CREATED BY:

PUBLIC ACT 91-541 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

This Act decoupled the Department from the federal loss limitations required by Section 382 of the Internal Revenue Code (IRC) and the separate return limitation year (SRLY) regulations promulgated under Section 1502 of the IRC for all tax years ending on or after December 31, 1986. Except for certain situations relating to refunds for tax assessed prior to January 1, 1999, all Illinois losses for years ending on or after December 31, 1986 will not be limited by Section 382 of the IRC or the separate return limitation year regulations promulgated under Section 1502 or the IRC.

AMENDED BY:

PUBLIC ACT 91-913 - EFFECTIVE: JANUARY 1, 2001

Deleted the language in subsection (a), which stated that no limitations on carryovers under IRC Section 382, or the separate return limitation year provisions of the federal consolidated return regulations applied to acquisitions governed by IRC Section 381.

Added subsection (b-5) which provides that no limitation under Section 382 of the IRC or the separate return limitation year regulations promulgated under Section 1502 of the IRC shall apply to the carryover of any Article 2 credit or net loss allowable under Section 207 of the IITA.

SECTION 501--NOTICE/REGULATIONS REQUIRING RECORDS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the requirement that every person liable for tax under this Act must keep such records, render such statements, make such returns and notices, and comply with such rules and regulations as the Department may prescribe from time to time.

AMENDED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Added subsection (b), requiring annual disclosure of tax shelter participations.

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SECTION 502--RETURNS AND NOTICES

SECTION 502(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

A return is required for every person that is liable for a tax imposed by this Act or, in the case of a resident or a corporation which is qualified to do business in Illinois, person required to file a federal income tax return whether the person is liable for tax or not.

AMENDED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Substituted the word "taxes" for "tax".

PUBLIC ACT 87-1246 - EFFECTIVE: DECEMBER 24, 1992

Eliminated the Illinois filing requirement for any person who has an Illinois base income of $1,000 or less and is either claimed as a dependent on another person's federal tax return or another person's Illinois Income Tax return.

PUBLIC ACT 90-613 – EFFECTIVE: JULY 9, 1998

Amended the Illinois filing requirement so that any person who has Illinois base income equal to or less than the basic amount in Section 204(b) is not required to file a return.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subsection to provide that no return is required from a nonresident whose liability is paid in full by withholding by a partnership, S corporation or trust.

PUBLIC ACT 97-0507-EFFECTIVE: AUGUST 23, 2011

Deleted extraneous language in reference to the IRC and added language to require pass-through entities who own other pass-through entities to file returns even if the withholding from the owned entity is sufficient to pay their replacement tax obligations.

SECTION 502(b)--FIDUCIARIES/RECEIVERS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the provisions for who may file the return for decedents, individuals under a disability, estates and trusts, and receivers, trustees and assignees for a corporation.

AMENDED BY:

PUBLIC ACT 83-706 - EFFECTIVE: SEPTEMBER 23, 1983

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Deleted the word "conservators" from Section 502(b)(2).

SECTION 502(c)--JOINT RETURNS BY HUSBAND AND WIFE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If a husband and wife file their federal income tax returns on a joint basis, they should file their Illinois returns on a joint basis. If they file their federal returns on a separate basis, they should file their Illinois returns in the same manner. The only exception to this is if either the husband or wife is an Illinois nonresident, they may elect to file their Illinois return joint or separate.

If neither spouse is required to file a federal income tax return, they may elect to file their Illinois return on either a joint or separate basis.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Added subsection (c)(4) providing innocent spouse relief.

PUBLIC ACT 88-669 - EFFECTIVE: NOVEMBER 29, 1994

Amends subsection (c)(4) to state that if there is no federal income tax liability at issue (and therefore no federal innocent spouse relief granted), the Department will rely upon the provisions of IRC Section 6013(e) to determine whether the person requesting innocent spouse relief is entitled to that relief.

PUBLIC ACT 91-541 - EFFECTIVE: FOR TAX LIABILITIES WHICH ARISE AFTER AUGUST 13, 1999 OR WHICH AROSE PRIOR TO AUGUST 13, 1999 BUT REMAIN UNPAID AS OF AUGUST 13, 1999

Added subsection (c)(4)(B), which provides that an individual elects innocent spouse treatment, the individual's liability under a joint return, may not exceed the individual's separate return amount.

PUBLIC ACT 92-846 – EFFECTIVE: AUGUST 23, 2002

Changes section (c)(4)(A) to read "for tax liabilities arising and paid prior to August 13, 1999". Changes section (c)(4)(B) to read "for tax liabilities arising on and after August 13, 1999". Makes other various wording changes to correct cross references to the IRC and to include references to determinations by federal courts.

PUBLIC ACT 96-520 - EFFECTIVE: AUGUST 14, 2009

For tax years ending on or after December 31, 2009, allows couples who file joint federal returns to elect to file joint or separate Illinois returns. Continues to require nonresident spouses of residents to be taxed as residents if a joint return is filed. Disallows "injured spouse" relief for joint filers.

SECTION 502(d)--PARTNERSHIPS

CREATED BY:

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PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Required partnerships to file information returns.

AMENDED BY:

PUBLIC ACT 87-879 - EFFECTIVE: JANUARY 1, 1993

Eliminated the requirement that partnerships include information concerning all items of income, gain, loss and deduction; the names and addresses of all partners; the distributive share of each partner; and other pertinent information with their returns. The information must now be retained by the partnerships and be available to the Department, when requested.

PUBLIC ACT 88-480 - EFFECTIVE: JANUARY 1, 1994

Added limited liability companies to the partnership provisions.

SECTION 502(e)--SUPPLEMENTAL RETURNS--DELETED

CREATED BY:

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Required supplemental returns for 1983 if a taxpayer filed a return for a year which ending during 1983 and the original return did not show a liability, which reflected the tax rate increase.

DELETED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

SECTION 502(e)--COMBINED RETURNS

CREATED BY:

PUBLIC ACT 83-1289 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1985

Allowed corporations (other than Subchapter S corporations) who are members of a unitary business group and have the same tax year end to elect to file a combined return and be treated as one taxpayer. The liability on the combined return was the sum of what would otherwise be the members' separate liabilities.

AMENDED BY:

PUBLIC ACT 84-221 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1985

Deleted the statement that the liability on the combined return was the sum of what would otherwise be the members' separate liabilities. Instead the Public Act incorporated the statement that the combined return liability was the group's tax liability under this Act.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Extended election to include members of unitary business groups (other than Subchapter S corporations) with differing year-ends to be included in the same combined return.

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PUBLIC ACT 88-195 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1993

Changed the ELECTION to file a combined return to a REQUIREMENT.

SECTION 502(f)--COMPOSITE RETURNS

CREATED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Allowed partners of partnerships, shareholders of Subchapter S corporations and individuals transacting business under a Lloyd's plan of operation to file a composite return to report their individual Illinois tax liabilities relating to these partnerships, Subchapter S corporations and Lloyd's plans of operation.

AMENDED BY:

PUBLIC ACT 88-480 - EFFECTIVE: JANUARY 1, 1994

Added nonresident individual members of a limited liability company that is treated as a partnership federally to the list of individuals allowed to file a composite return.

PUBLIC ACT 91-913 - EFFECTIVE: JANUARY 1, 2001

Provides that for tax years ending on or after December 31, 1999, the Department may, by regulation, permit any persons transacting an insurance business organized under a Lloyds plan of operation to file composite returns reflecting the income of such persons allocable to Illinois and shall, by regulation, also provide that the income and apportionment factors attributable to the transaction of an insurance business organized under a Lloyds plan of operation by any person joining in the filing of a composite return shall, for purposes of allocating and apportioning income and computing net income, be excluded from any other income and apportionment factors of that person or of any unitary business group, to which that person may belong.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subsection to provide that every nonresident may claim a credit for taxes paid on his or her behalf on a composite return.

PUBLIC ACT 98-478 - EFFECTIVE: AUGUST 16, 2013

Provides that composite returns may only be filed for tax years ending prior to December 31, 2014.

SECTION 502(f-5)--PAYMENT OF OWNER LIABILITIES BY PASS-THROUGHS

CREATED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Added this subsection to allow pass-through entities to claim refunds and pay deficiencies based on erroneous partnership items on behalf of their owners, as provided by regulations.

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SECTION 502(g)--ELECTRONIC FILING

CREATED BY:

PUBLIC ACT 88-480 - EFFECTIVE: JANUARY 1, 1994

The Department may adopt rules to authorize the electronic filing of any return required to be filed under this Section.

AMENDED BY:

No amendments.

SECTION 502.1—USE TAX

CREATED BY:

PUBLIC ACT 96-1388 - EFFECTIVE: JULY 29, 2010

Requires the Department to allow Use Tax filing on the individual income tax return.

SECTION 503--SIGNING OF RETURNS/NOTICES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the requirements for who should sign returns and notices for individuals, corporations, partnerships, or joint fiduciaries. The section also states that the fact that the person signed the return is prima facie evidence that they have the authority to sign the return.

AMENDED BY:

PUBLIC ACT 82-1009 - EFFECTIVE: SEPTEMBER 17, 1982

Added statement to Section 503(a), which states that if the return is completed by a Tax Preparer for an individual, the Preparer must also sign the return as such.

PUBLIC ACT 85-731 - EFFECTIVE: RETROACTIVE TO AUGUST 1, 1969

Added subsection (e) which states that if a taxpayer fails to sign a return within 6 months after proper notice and demand for signature is made by the Department, the return shall be considered valid and any amount shown to be due on the return is deemed assessed. Any overpayment shown on the return will be considered forfeited if the taxpayer fails to provide a signature for the return within 3 years from the date the return was filed IF the Department has issued a proper notice and demand for the signature.

PUBLIC ACT 87-879 - EFFECTIVE: JANUARY 1, 1993

Amends subsection (a) to state that if a return is transmitted electronically, it will be presumed that the electronic return originator has obtained and is transmitting a valid signature document.

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Also amends subsection (e) to state that if an overpayment of tax is refunded based on an electronically filed return and, within 6 months after proper notification by the Department, the required signature document is not provided, the refund will be considered erroneous.

PUBLIC ACT 88-480 - EFFECTIVE: JANUARY 1, 1994

Added that a manager or member should sign limited liability company returns.

PUBLIC ACT 88-672 - EFFECTIVE: DECEMBER 14, 1994

Amends subsection (a) to state that the Department may authorize electronic return originators to maintain the signature documents and associated documentation, subject to the Department's right of inspection at any time without notice, rather than transmitting those documents to the Department.

PUBLIC ACT 89-379 - EFFECTIVE: JANUARY 1, 1996

Provides that if a taxpayer fails to sign a return within 30 days after proper notice and demand for signature by the Department, the return shall be considered valid and any amount shown on the return shall be deemed assessed.

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

Eliminates the six months waiting period for providing a signature before a refund can be considered erroneous.

PUBLIC ACT 99-0641- EFFECTIVE: JANUARY 1, 2017

Requires return preparers to include their PTINs on returns they prepare.

SECTION 504--VERIFICATION

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Returns are signed under penalty of perjury.

AMENDED BY:

PUBLIC ACT 82-1009 - EFFECTIVE: SEPTEMBER 17, 1982

Added statement that the signing of a fraudulent return constitutes perjury.

SECTION 505--TIME/PLACE FOR FILING RETURNS

SECTION 505(a)(1)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

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Returns are required to be filed at the place prescribed by the Department. Returns are due on or before the 15th day of the fourth month following the close of the taxable year unless the Director grants an extension or extensions of time for such filing.

AMENDED BY:

PUBLIC ACT 79-6thSS-3 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1976

Deleted all of subsection except for statement regarding the place for filing returns. (The remainder of the subsection was moved to subsection (a)(2).)

SECTION 505(a)(1)--CORPORATIONS

CREATED BY:

PUBLIC ACT 79-6thSS-3 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1976

Corporate returns were required to be filed by the 15th day of the third month following the close of the tax year unless an extension is granted by the Department (not to exceed 6 months).

AMENDED BY:

PUBLIC ACT 84-127 - EFFECTIVE: AUGUST 1, 1985

Added the statement "unless the income or loss of a taxpayer is reported for federal purposes on a return with a due date later than the 15th day of the third month following the close of the taxable year, in which case the same due date shall apply to the corresponding Illinois return."

SECTION 505(a)(2)--INDIVIDUALS, PARTNERSHIPS, FIDUCIARIES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Individual, partnership and fiduciary returns are required to be filed on or before the 15th day of the fourth month following the close of the tax year unless an extension of time is granted (not to exceed 6 months). Special rule for decedents. (This was originally Section 505(a) but was moved to Section 505(a)(2) by PA 79-6thSS-3.)

AMENDED BY:

No amendments.

SECTION 505(a)(3)--CERTAIN EXEMPT ORGANIZATIONS

CREATED BY:

PUBLIC ACT 82-609 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1982

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Allowed certain exempt organizations to file their Illinois returns on or before the 15th day of the fifth month following the close of the tax year unless an extension of time is granted (not to exceed 6 months).

AMENDED BY:

No amendments.

SECTION 505(b)--FEDERAL FILING EXTENSIONS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If a taxpayer has an extension of time to file the federal return, the same amount of time is automatically given to the taxpayer for Illinois purposes if a copy of the federal extension is attached to the Illinois return when it is filed. The extension is only granted if the provisions of Section 602 are met.

AMENDED BY:

PUBLIC ACT 84-1400 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

Corporations are given an additional month past the federal extension in which to file their Illinois returns if the provisions of Section 602 are met.

SECTION 505(c)--EXTENSION OF TIME FOR FILING WHEN ABROAD

CREATED BY:

PUBLIC ACT 83-1028 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1983

If an individual is living or traveling abroad on the 15th day of the fourth month following the close of the tax year, the Illinois return is required to be filed no earlier than the 15th day of the sixth month following the close of the tax year.

AMENDED BY:

No amendments.

SECTION 506--FEDERAL RETURNS

SECTION 506(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any person required to file an Illinois return might be required to furnish a copy of any federal return involved to the Department.

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AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Added the provision that other state returns may be required to be furnished.

PUBLIC ACT 86-905 - EFFECTIVE: SEPTEMBER 11, 1989

Deleted provisions regarding "other state" returns.

SECTION 506(b)--FEDERAL CHANGES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Requires that any federal change which occurs and which affects the taxpayer's base income amount must be reported to Illinois on an amended return (or other manner prescribed by the Department) within 20 days of the finalization date.

AMENDED BY:

PUBLIC ACT 76-2407 - EFFECTIVE: JULY 1, 1970

Added the statement that any change in the number of personal exemptions allowed federally must also be reported to Illinois.

PUBLIC ACT 78-268 - EFFECTIVE: AUGUST 13, 1973

Added the statement that the alteration must be reported to the state within 20 days of when a federal tentative carryback adjustment was paid.

PUBLIC ACT 84-1128 - EFFECTIVE: JULY 1, 1986

Extended the period for reporting federal changes from 20 days to 120 days. (This same amendment was made by PA 84-1429.)

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Requires that taxpayers report "other state" changes which are finalized on or after January 1, 1988 and which affect base income allocable to Illinois.

PUBLIC ACT 86-905 - EFFECTIVE: SEPTEMBER 11, 1989

Deleted requirement to report "other state" changes. Also revised the remainder of the section to refer to federal changes affecting base income rather than base income allocable to Illinois.

PUBLIC ACT 90-491 - EFFECTIVE: FOR FEDERAL AUDITS FINALIZED ON OR AFTER JANUARY 1, 1998

Amends the changes affecting federal income tax section to include any changes to a federal tax credit. Also expands the provision to state any federal changes that affect net income, net loss or any Article 2 credit.

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PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Renumbers existing subsection (b) as (b)(1) and adds a new paragraph (2), which provides that employers must report changes affecting federal income taxes if the change affects the Amount of compensation subject to withholding by the employer.

PUBLIC ACT 97-0507-EFFECTIVE: AUGUST 23, 2011

Made technical changes to (b)(1) to refer to changes to amended federal returns as well as originals, and to refer to alterations by the IRS and the courts.

SECTION 506.5--RETURNS BASED ON SUBSTITUTE W-2 FORMS

CREATED BY:

PUBLIC ACT 88-669 - EFFECTIVE: NOVEMBER 29, 1994

If a taxpayer loses a W-2 or was not provided a W-2, cannot obtain a duplicate W-2 and subsequently obtains a substitute W-2 from the IRS, it will be presumed that the Illinois income tax withheld amount is appropriate if:

* The amount of the federal taxes withheld is appropriate;
* A copy of the substitute W-2 accompanies the original return when filed; and
* The taxpayer provides a mailing address to which any correspondence and/or refund may be mailed.

AMENDED BY:

No amendments.

SECTION 507--CHILD ABUSE PREVENTION CHECK-OFF - DELETED

CREATED BY:

PUBLIC ACT 83-1066 - EFFECTIVE: JANUARY 5, 1984

Provided for a check-off on individual returns for an amount of $10 or the amount of the refund whichever is less to be contributed to the Child Abuse Prevention Fund.

AMENDED BY:

PUBLIC ACT 84-261 - EFFECTIVE: FOR TAX YEARS ENDING ON OR BEFORE DECEMBER 31, 1985

Added provision that the check-off will be eliminated if, in any calendar year, contributions do not equal or exceed $100,000.

PUBLIC ACT 85-731 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Amended provision to read that the check-off will be eliminated if, by October 1 of any year, contributions do not equal or exceed $100,000.

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PUBLIC ACT 86-678 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1989

Changes the provisions regarding contributing to the check-off funds. The amount of contribution is not limited to the amount of refund due a taxpayer. The taxpayer can state the amount being contributed (in excess of $1) and the amount will either reduce the refund or increase the amount due on the return. Failure to pay the amount due will decrease the contribution. This section does not apply to amended returns.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507A--COMMUNITY HEALTH CENTER CARE FUND CHECK-OFF - DELETED

CREATED BY:

PUBLIC ACT 86-996 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1989

This section contains the procedures for claiming the check-off for the Community Health Center Care Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507B--CHILD CARE EXPANSION PROGRAM FUND CHECK-OFF - DELETED

CREATED BY:

PUBLIC ACT 86-995 - EFFECTIVE: DECEMBER 13, 1989

This section contains the procedures for claiming the check-off for the Child Care Expansion Program Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507C--YOUTH DRUG ABUSE PREVENTION CHECK-OFF - DELETED

CREATED BY:

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PUBLIC ACT 87-342 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1991

This section contains the procedures for claiming the check-off for the Youth Drug Abuse Prevention Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507D--RYAN WHITE AIDS VICTIMS ASSISTANCE CHECK-OFF - DELETED

CREATED BY:

PUBLIC ACT 87-342 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1991

This section contains the procedures for claiming the check-off for the Ryan White AIDS Victims Assistance Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507E--DISABILITY ASSISTANCE CHECK-OFF - DELETED

CREATED BY:

PUBLIC ACT 87-342 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1991

This section contains the procedures for claiming the check-off for the Assistive Technology for Persons with Disabilities Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507F--DOMESTIC VIOLENCE SHELTER/SERVICE CHECK-OFF - DELETED

CREATED BY:

PUBLIC ACT 87-342 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1991

This section contains the procedures for claiming the check-off for the Domestic Violence Shelter and Service Fund.

DELETED BY:

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PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507G--US OLYMPIANS ASSISTANCE CHECK-OFF - DELETED

CREATED BY:

PUBLIC ACT 87-342 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1991

This section contains the procedures for claiming the check-off for the United States Olympians Assistance Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507H--PERSIAN GULF CONFLICT CHECK-OFF - DELETED

CREATED BY:

PUBLIC ACT 87-119 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1991

This section contains the procedures for claiming the check-off for the Persian Gulf Conflict Veterans Fund.

AMENDED BY:

PUBLIC ACT 87-895 - EFFECTIVE: JULY 14, 1992

Re-lettered the check-off from C to H.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507I--LITERACY ADVANCEMENT FUND CHECK-OFF - DELETED

CREATED BY:

PUBLIC ACT 87-992 - EFFECTIVE: SEPTEMBER 1, 1992

This section contains the procedures for claiming the check-off for the Literacy Advancement Fund.

DELETED BY:

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PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507J--RYAN WHITE PEDIATRIC AND ADULT AIDS FUND CHECKOFF - DELETED

CREATED BY:

PUBLIC ACT 88-459 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1993

This section contains the procedures for claiming the check-off for the Ryan White Pediatric and Adult AIDS Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507K--ILLINOIS SPECIAL OLYMPICS FUND - DELETED

CREATED BY:

PUBLIC ACT 88-459 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1993

This section contains the procedures for claiming the check-off for the Illinois Special Olympics Checkoff Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section if repealed on July 1, 2002.

SECTION 507L--PENNY SEVERNS BREAST AND CERVICAL CANCER RESEARCH FUND

CREATED BY:

PUBLIC ACT 88-459 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1993

This section contains the procedures for claiming the check-off for the Breast and Cervical Cancer Research Fund.

AMENDED BY:

PUBLIC ACT 91-107 - EFFECTIVE: JULY 13, 1999

Changes the name of the Breast and Cervical Cancer Research Fund and checkoff to the Penny Severns Breast and Cervical Cancer Research Fund and checkoff.

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PUBLIC ACT 99-0933- EFFECTIVE: January 27, 2017

Changes the name of the Penny Severns Breast and Cervical Cancer Research Fund and checkoff to the Penny Severns Breast, Cervical, and Ovarian Cancer Research Fund and checkoff.

SECTION 507M--MEALS ON WHEELS FUND - DELETED

CREATED BY:

PUBLIC ACT 88-459 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1993

This section contains the procedures for claiming the check-off for the Meals on Wheels Fund. This check-off will only be added to the return if another checkoff does not receive enough contributions to continue its existence.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507N--KOREAN WAR MEMORIAL FUND - DELETED

CREATED BY:

PUBLIC ACT 88-666 - EFFECTIVE: SEPTEMBER 16, 1994

This section contains the procedures for claiming the check-off for the Korean War Memorial Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507O--HEART DISEASE TREATMENT & PREVENTION FUND - DELETED

CREATED BY:

PUBLIC ACT 88-666 - EFFECTIVE: SEPTEMBER 16, 1994

This section contains the procedures for claiming the check-off for the Heart Disease Treatment and Prevention Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

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SECTION 507P--HEMOPHILIA TREATMENT FUND - DELETED

CREATED BY:

PUBLIC ACT 88-666 - EFFECTIVE: SEPTEMBER 16, 1994

This section contains the procedures for claiming the check-off for the Hemophilia Treatment Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507Q--WOMEN IN MILITARY SERVICE MEMORIAL FUND - DELETED

CREATED BY:

PUBLIC ACT 89-230 - EFFECTIVE: AUGUST 4, 1995

This section contains the procedures for claiming the check-off for the Women in Military Service Memorial Fund.

DELETED BY:

PUBLIC ACT 91-833 - EFFECTIVE: JANUARY 1, 2001

This section is repealed on January 1, 2001.

SECTION 507R--MENTAL HEALTH RESEARCH FUND - DELETED

CREATED BY:

PUBLIC ACT 90-171 - EFFECTIVE: JULY 23, 1997

Creates a new individual income tax check-off for contributions to the Mental Health Research Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507S--CHILDREN'S CANCER RESEARCH FUND - DELETED

CREATED BY:

PUBLIC ACT 90-171 - EFFECTIVE: JULY 23, 1997

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Creates a new individual income tax check-off for contributions to the Children's Cancer Research Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507T--AMERICAN DIABETES ASSOCIATION FUND - DELETED

CREATED BY:

PUBLIC ACT 90-171 - EFFECTIVE: JULY 23, 1997

Creates a new individual income tax check-off for contributions to the American Diabetes Association Fund.

DELETED BY:

PUBLIC ACT 92-84 - EFFECTIVE: JULY 12, 2001

This section is repealed on July 1, 2002.

SECTION 507U--PROSTATE CANCER RESEARCH FUND

CREATED BY:

PUBLIC ACT 91-104 - EFFECTIVE: JULY 13, 1999

Creates a new individual income tax check-off for contributions to the Prostate Cancer Research Fund.

AMENDED BY:

No Amendments.

SECTION 507V--NATIONAL WORLD WAR II MEMORIAL FUND CHECKOFF

CREATED BY:

PUBLIC ACT 91-833 - EFFECTIVE: JANUARY 1, 2001
PUBLIC ACT 91-836 - EFFECTIVE: JANUARY 1, 2001

Creates a new individual income tax check-off for contributions to the National World War II Memorial Fund. This checkoff was created by Public Acts, 91-833 and 91-836 which are identical.

AMENDED BY:

No Amendments.

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SECTION 507W--KOREAN WAR VETERANS NATIONAL MUSEUM AND LIBRARY FUND

CREATED BY:

PUBLIC ACT 92-198 - EFFECTIVE: AUGUST 1, 2001

For tax years ending on or after December 31, 2001, creates the Korean War Veterans National Museum and Library Fund checkoff.

DELETED BY:

PUBLIC ACT 99-0576 - EFFECTIVE: July 15, 2016

SECTION 507X--THE MULTIPLE SCLEROSIS ASSISTANCE FUND CHECKOFF

CREATED BY:

PUBLIC ACT 92-772 - EFFECTIVE: AUGUST 6, 2002

For tax years ending on or after December 31, 2002, creates an individual checkoff for contributions to the Multiple Sclerosis Assistance Fund.

SECTION 507Y—ILLINOIS MILITARY FAMILY RELIEF CHECKOFF

CREATED BY:

PUBLIC ACT 92-886 - EFFECTIVE: FEBRUARY 7, 2003

For tax years ending on or after December 31, 2003, creates a checkoff for contributions to the asthma and lung research fund.

AMENDED BY:

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Recodified provision from 507X to 507Y.

SECTION 507Z--WORLD WAR II VETERANS MEMORIAL CHECKOFF

CREATED BY:

PUBLIC ACT 93-131 - EFFECTIVE: JULY 10, 2003

For tax years ending on or after December 31, 2003, creates a checkoff for contributions to the World War II Veterans Memorial fund.

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SECTION 507AA--LOU GHERIG'S DISEASE CHECKOFF

CREATED BY:

PUBLIC ACT 93-36 - EFFECTIVE: JUNE 24, 2003

For tax years ending on or after December 31, 2003, creates a checkoff for contributions to the Lou Gehrig's disease research fund.

AMENDED BY:

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Recodified provision from 507Y to 507AA.

SECTION 507BB--ASTHMA AND LUNG RESEARCH CHECKOFF

CREATED BY:

PUBLIC ACT 93-292 - EFFECTIVE: JULY 22, 2003

For tax years ending on or after December 31, 2003, creates a checkoff for contributions to the asthma and lung research fund.

AMENDED BY:

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Recodified provision from 507Y to 507BB.

SECTION 507CC--LEUKEMIA RESEARCH CHECKOFF

CREATED BY:

PUBLIC ACT 93-324 - EFFECTIVE: JULY 23, 2003

For tax years ending on or after December 31, 2003, creates a checkoff for contributions to the Leukemia research fund.

AMENDED BY:

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Recodified provision from 507Y to 507CC.

REPEALED BY:

PUBLIC ACT 101-275 – EFFECTIVE AUGUST 19, 2019

SECTION 507DD--ILLINOIS VETERANS HOME CHECKOFF

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CREATED BY:

PUBLIC ACT 93-776 - EFFECTIVE: JULY 21, 2004

For tax years ending on or after December 31, 2004, creates a checkoff for contributions to the Illinois Veterans' home.

SECTION 507EE--PET POPULATION CONTROL FUND CHECKOFF

CREATED BY:

PUBLIC ACT 94-369 - EFFECTIVE: AUGUST 22, 2005

Creates a checkoff for contributions to the pet population control fund.

DELETED BY:

PUBLIC ACT 99-0933- EFFECTIVE: January 27, 2017

SECTION 507FF--EPILEPSY TREATMENT AND GRANTS-IN-AID FUND CHECKOFF

CREATED BY:

PUBLIC ACT 94-73 - EFFECTIVE: JUNE 23, 2005

Creates a checkoff for contributions to the epilepsy treatment and grants-in-aid fund.

AMENDED BY:

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Recodified provision from 507EE to 507FF and changed reference to enacting legislation.

SECTION 507GG--DIABETES RESEARCH FUND CHECKOFF

CREATED BY:

PUBLIC ACT 94-107 - EFFECTIVE: JULY 1, 2005

Creates a checkoff for contributions to the diabetes research fund.

AMENDED BY:

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Recodified provision from 507EE to 507GG and changed reference to enacting legislation.

PUBLIC ACT 100-201 - EFFECTIVE: AUGUST 18, 2017

Corrects a typographical error.

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SECTION 507HH--SARCOIDOSIS RESEARCH FUND CHECKOFF

CREATED BY:

PUBLIC ACT 94-141 - EFFECTIVE: JULY 8, 2005

Creates a checkoff for contributions to the sarcoidosis research fund.

AMENDED BY:

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Recodified provision from 507EE to 507HH and changed reference to enacting legislation.

REPEALED BY:

PUBLIC ACT 101-275 – EFFECTIVE AUGUST 19, 2019

SECTION 507II--VINCE DEMUZIO MEMORIAL COLON CANCER FUND CHECKOFF

CREATED BY:

PUBLIC ACT 94-142 - EFFECTIVE: JULY 8, 2005

Creates a checkoff for contributions to the Vince DeMuzio memorial colon cancer fund.

AMENDED BY:

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Recodified provision from 507EE to 507II and changed reference to enacting legislation.

REPEALED BY:

PUBLIC ACT 101-275 – EFFECTIVE AUGUST 19, 2019

SECTION 507JJ--AUTISM RESEARCH FUND CHECKOFF

CREATED BY:

PUBLIC ACT 94-442 - EFFECTIVE: AUGUST 4, 2005

Creates a checkoff for contributions to the autism research fund.

AMENDED BY:

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Recodified provision from 507EE to 507JJ and changed reference to enacting legislation.

PUBLIC ACT 98-463 - EFFECTIVE: AUGUST 16, 2013

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Added “checkoff” to the title and the text.

SECTION 507KK--BLINDNESS PREVENTION FUND CHECKOFF

CREATED BY:

PUBLIC ACT 94-602 - EFFECTIVE: AUGUST 16, 2005

Creates a checkoff for contributions to the blindness prevention fund.

AMENDED BY:

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Recodified provision from 507EE to 507KK and changed reference to enacting legislation.

REPEALED BY:

PUBLIC ACT 101-275 – EFFECTIVE AUGUST 19, 2019

SECTION 507LL--ILLINOIS BRAIN TUMOR RESEARCH CHECKOFF

CREATED BY:

PUBLIC ACT 94-649 - EFFECTIVE: AUGUST 22, 2005

Creates a checkoff for contributions to the Illinois brain tumor research fund.

AMENDED BY:

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Recodified provision from 507EE to 507LL and changed reference to enacting legislation.

REPEALED BY:

PUBLIC ACT 101-275 – EFFECTIVE AUGUST 19, 2019

SECTION 507MM--SUPPLEMENTAL LOW-INCOME ENERGY ASSISTANCE FUND CHECKOFF

CREATED BY:

PUBLIC ACT 94-773 - EFFECTIVE: MAY 18, 2006

Creates a checkoff for contributions to the supplemental low-income energy assistance fund.

DELETED BY:

PUBLIC ACT 99-0933- EFFECTIVE: January 27, 2017

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SECTION 507NN--HEARTSAVER AED FUND CHECKOFF

CREATED BY:

PUBLIC ACT 94-876 - EFFECTIVE: JUNE 19, 2006

Creates a checkoff for contributions to the heartsaver AED fund.

AMENDED BY:

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Recodified provision from 507EE to 507NN.

DELETED BY:

PUBLIC ACT 99-0933- EFFECTIVE: January 27, 2017

SECTION 507PP--LUNG CANCER RESEARCH CHECKOFF

CREATED BY:

PUBLIC ACT 95-434 - EFFECTIVE: AUGUST 27, 2007

Creates a checkoff for contributions to the lung cancer research fund.

AMENDED BY:

PUBLIC ACT 95-0876 – EFFECTIVE AUGUST 21, 2008

Recodified provision from 507OO to 507PP.

REPEALED BY:

PUBLIC ACT 101-275 – EFFECTIVE AUGUST 19, 2019

SECTION 507QQ--AUTOIMMUNE DISEASE RESEARCH CHECKOFF

CREATED BY:

PUBLIC ACT 95-435 - EFFECTIVE: August 27, 2007

Creates a checkoff for contributions to the autoimmune disease research fund.

AMENDED BY:

PUBLIC ACT 95-0876 – EFFECTIVE AUGUST 21, 2008

Recodified provision from 507OO to 507QQ.

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SECTION 507RR--HEALTHY SMILES FUND CHECKOFF

CREATED BY:

PUBLIC ACT 95-940 - EFFECTIVE: August 29, 2008

Creates a checkoff for contributions to the Healthy Smiles fund.

AMENDED BY:

PUBLIC ACT 96-328 - EFFECTIVE: AUGUST 11, 2009

Recodified 507 PP as 507RR.

DELETED BY:

PUBLIC ACT 99-0933- EFFECTIVE: January 27, 2017

SECTION 507SS--HUNGER RELIEF FUND CHECKOFF

CREATED BY:

PUBLIC ACT 96-604 - EFFECTIVE: AUGUST 24, 2009

Creates a checkoff for contributions to the hunger relief fund.

AMENDED BY:

PUBLIC ACT 96-1000 - EFFECTIVE: JULY 2, 2010

Amended to refer to Public Act 96-627.

SECTION 507TT--CRISIS NURSERY FUND CHECKOFF

CREATED BY:

PUBLIC ACT 96-627 - EFFECTIVE: AUGUST 24, 2009

Creates a checkoff for contributions to the crisis nursery fund as Section 507SS.

AMENDED BY:

PUBLIC ACT 96-1000 - EFFECTIVE: JULY 2, 2010

Recodified as Section 507TT and amended to refer to Public Act 96-627.

SECTION 507UU--ILLINOIS ROUTE 66 CHECKOFF

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CREATED BY:

PUBLIC ACT 96-1424 - EFFECTIVE: AUGUST 3, 2010

Creates a checkoff for contributions to the Illinois Route 66 fund.

DELETED BY:

PUBLIC ACT 99-0576 - EFFECTIVE: July 15, 2016

SECTION 507VV--HABITAT FOR HUMANITY CHECKOFF

CREATED BY:

PUBLIC ACT 96-1424 - EFFECTIVE: AUGUST 3, 2010

Creates a checkoff for contributions to Habitat for Humanity.

DELETED BY:

PUBLIC ACT 99-0576 - EFFECTIVE: July 15, 2016

SECTION 507WW--STATE PARKS CHECKOFF

CREATED BY:

PUBLIC ACT 96-1424 - EFFECTIVE: AUGUST 3, 2010

Creates a checkoff for contributions to state parks.

DELETED BY:

PUBLIC ACT 99-0933- EFFECTIVE: January 27, 2017

SECTION 507XX--DISABLED VETERANS PROPERTY TAX RELIEF CHECKOFF

CREATED BY:

PUBLIC ACT 96-1424 - EFFECTIVE: AUGUST 3, 2010

Creates a checkoff for contributions to the Disabled Veterans Property Tax Relief Fund.

AMENDED BY:

PUBLIC ACT 99-0143 - EFFECTIVE: JULY 27, 2015

Amended wording to change references to "disabled" veterans to "veterans with disabilities".

REPEALED BY:

PUBLIC ACT 100-621 – EFFECTIVE: JULY 20, 2018

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SECTION 507YY--CRIME STOPPERS CHECKOFF

CREATED BY:

PUBLIC ACT 97-0478- EFFECTIVE: AUGUST 22, 2011

Creates a checkoff for contributions to the Crime Stoppers Fund.

SECTION 507ZZ--AFTER-SCHOOL RESCUE CHECKOFF

CREATED BY:

PUBLIC ACT 97-0478-EFFECTIVE: AUGUST 22, 2011

Creates a checkoff for contributions to the After-School Rescue Fund.

SECTION 507AAA--CHILDHOOD CANCER RESEARCH CHECKOFF

CREATED BY:

PUBLIC ACT 97-1117- EFFECTIVE: AUGUST 27, 2012

Creates a checkoff for contributions to the Childhood Cancer Research Checkoff.

SECTION 507BBB--CHILDREN'S WELLNESS CHARITIES CHECKOFF

CREATED BY:

PUBLIC ACT 97-1117- EFFECTIVE: AUGUST 27, 2012

Creates a checkoff for contributions to the Children's Wellness Charities Checkoff.

SECTION 507CCC--HOUSING FOR FAMILIES CHECKOFF

CREATED BY:

PUBLIC ACT 97-1117- EFFECTIVE: AUGUST 27, 2012

Crates a checkoff for contributions to the Housing for Families Checkoff.

SECTION 507DDD – SPECIAL OLYMPICS ILLINOIS AND SPECIAL CHILDREN'S CHECKOFF

CREATED BY:

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PUBLIC ACT 99-0423- EFFECTIVE: AUGUST 20, 2015

Creates a checkoff for contributions to the Special Olympics Illinois and Special Children's Charities Checkoff Fund.

PUBLIC ACT 99-0642- EFFECTIVE: JULY 28, 2016

Corrects cross references.

SECTION 507EEE- U.S.S. ILLINOIS COMMISSIONING FUND CHECKOFF

CREATED BY:

PUBLIC ACT 99-0423- EFFECTIVE: AUGUST 20, 2015

Creates a checkoff for contributions to the U.S.S. Illinois Commissioning Fund.

SECTION 507FFF – AUTISM CARE FUND CHECKOFF

CREATED BY:

PUBLIC ACT 99-0423- EFFECTIVE: AUGUST 20, 2015

Creates a checkoff for contributions to the Autism Care Fund.

SECTION 507GGG – THRIVING YOUTH CHECKOFF

CREATED BY:

PUBLIC ACT 100-329- EFFECTIVE: AUGUST 24, 2017

Creates a checkoff for contributions to the thriving youth.

SECTION 507HHH – ILLINOIS POLICE MEMORIAL CHECKOFF

CREATED BY:

PUBLIC ACT 100-329- EFFECTIVE: AUGUST 24, 2017

Creates a checkoff for contributions to the criminal justice information projects fund.

SECTION 507III – HUNGER RELIEF FUND CHECKOFF

CREATED BY:

PUBLIC ACT 100-1014- EFFECTIVE: JANUARY 1, 2019

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Creates a checkoff for contributions to the hunger relief fund.

SECTION 508--TRANSFER OF CHECK-OFF FUNDS

CREATED BY:

PUBLIC ACT 83-1066 - EFFECTIVE: JANUARY 5, 1984

The Department will determine the amount contributed to the Child Abuse Prevention Fund and will notify the State Comptroller and State Treasurer of the amount to be transferred into such fund.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Added the provision that the Department will determine the amount to be transferred as of October 1 of each year.

SECTION 509--TAX CHECK-OFF EXPLANATIONS

CREATED BY:

PUBLIC ACT 83-406 - EFFECTIVE: SEPTEMBER 17, 1983

Provided for a check-off on individual returns for tax years ending on or after December 31, 1983 for contributions to the Illinois Non-Game Wildlife Conservation Fund. (This was originally Section 507.)

AMENDED BY:

PUBLIC ACT 83-1412 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1984

Substituted December 31, 1984 for December 31, 1983. Added the Illinois Food & Housing Assistance Fund check-off.

PUBLIC ACT 84-261 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1985

Substituted December 31, 1985 for December 31, 1984. Added the Mental Health Education Fund check-off.

PUBLIC ACT 84-324 - EFFECTIVE: FOR TAX YEARS ENDING ON OR BEFORE DECEMBER 31, 1985

Added the Alzheimer's Disease Research Fund check-off.

PUBLIC ACT 85-293 - EFFECTIVE: SEPTEMBER 8, 1987

Provides that any check-off will be eliminated if, in any calendar year, the contributions to that fund do not equal or exceed $100,000.

PUBLIC ACT 85-380 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Added check-off for the United States Olympic Committee Fund.

PUBLIC ACT 85-409 - EFFECTIVE: SEPTEMBER 15, 1987

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Added a check-off for the Assistance to the Blind Fund.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Amended the section to state that if, by October 1 of any year, the contributions to any check-off fund do not equal or exceed $100,000, the check-off will be eliminated. Also deleted the checkoffs for the Illinois Food and Housing Assistance Fund and the Mental Health Education Fund.

PUBLIC ACT 86-678 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1989

Added the Child Abuse Prevention Fund to the check-off program under this section. Also states that the contribution will decrease the taxpayer's refund or increase the amount due on the return. Failure to pay an amount due will decrease the contribution amount. Deleted the check-offs for the United States Olympic Committee Fund and the Assistance to the Blind Fund.

PUBLIC ACT 86-960 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1989

Added a check-off for the Assistance to the Homeless Fund.

PUBLIC ACT 86-995 - EFFECTIVE: DECEMBER 13, 1989

Added a check-off for the Child Care Expansion Program Fund.

PUBLIC ACT 86-996 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1989

Added a check-off for the Community Health Center Care Fund.

PUBLIC ACT 87-119 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1991

Added a check-off for the Persian Gulf Conflict Veterans Fund.

PUBLIC ACT 87-342 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1991

Added check-offs for the Youth Drug Abuse Prevention Fund, the Ryan White AIDS Victims Assistance Fund, the Assistive Technology for Persons with Disabilities Fund, the Domestic Violence Shelter and Service Fund and the United States Olympians Assistance Fund.

PUBLIC ACT 87-992 - EFFECTIVE: SEPTEMBER 1, 1992

Added a check-off for the Literacy Advancement Fund.

PUBLIC ACT 88-459 - EFFECTIVE: AUGUST 20, 1993

Added check-offs for the Ryan White Pediatric and Adult AIDS Fund, the Illinois Special Olympics Fund, the Breast and Cervical Cancer Research Fund and the Meals on Wheels Fund.

PUBLIC ACT 88-666 - EFFECTIVE: SEPTEMBER 16, 1994

Added check-offs for the Korean War Memorial Fund, the Heart Disease Treatment and Prevention Fund and the Hemophilia Treatment Fund.

PUBLIC ACT 89-239 - EFFECTIVE: AUGUST 4, 1995

Added check-off for the Women in Military Service Memorial Fund.

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PUBLIC ACT 90-171 - EFFECTIVE: JULY 23, 1997

Added check-offs for contributions to the Mental Health Research Fund, the Children's Cancer Research Fund and the American Diabetes Association Fund.

PUBLIC ACT 91-104 - EFFECTIVE: JULY 13, 1999

Added a check-off for contributions to the Prostate Cancer Research Fund.

PUBLIC ACT 91-107 - EFFECTIVE: JULY 13, 1999

Changes the name of the Breast and Cervical Cancer Research Fund to the Penny Severns Breast and Cervical Cancer Research Fund.

PUBLIC ACT 91-833 and 91-836 EFFECTIVE: JANUARY 1, 2001

Added the National World War II Memorial Fund and deleted the Women in Military Service Memorial Fund.

PUBLIC ACT 92-84 - EFFECTIVE: JULY 1, 2002

Deletes checkoffs for Community Health Center Care Fund, Heritage Preservation Fund, Child Care Expansion Program Fund, Ryan White AIDS Victims Assistance Fund, Assistive Technology for Persons with Disabilities Fund, Domestic Violence Shelter and Service Fund, United States Olympians Assistance Fund, Youth Drug Abuse Prevention Fund, Persian Gulf Conflict Veterans Fund, Literacy Advancement Fund, Ryan White Pediatric and Adult AIDS Fund, Illinois Special Olympics Fund, Korean War Memorial Fund, Heart Disease Treatment and Prevention Fund, Hemophilia Treatment Fund, Mental Health Research Fund, Children’s Cancer Fund, American Diabetes Association Fund and the Meals on Wheels Fund.

PUBLIC ACT 92-198 - EFFECTIVE: AUGUST 1, 2001

Added the Korean War Veterans National Museum and Library Fund checkoff.

PUBLIC ACT 92-772 - EFFECTIVE: AUGUST 6, 2002

Added a checkoff for contributions to the Multiple Sclerosis Assistance fund.

PUBLIC ACT 93-292 - EFFECTIVE: JULY 22, 2003

Added a checkoff for contributions to the asthma and lung research fund.

PUBLIC ACT 93-36 - EFFECTIVE: JUNE 24, 2003

Added a checkoff for contributions to the Lou Gehrig’s disease research fund.

PUBLIC ACT 93-324 - EFFECTIVE: JULY 23, 2003

Added a checkoff for contributions to the Leukemia research fund.

PUBLIC ACT 93-131 - EFFECTIVE: JULY 10, 2003

Added a checkoff for contributions to the World War II Veterans Memorial fund.

PUBLIC ACT 93-776 - EFFECTIVE: JULY 21, 2004

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Added a checkoff for contributions to the Illinois Veterans' home.

PUBLIC ACT 94-369 - EFFECTIVE: AUGUST 22, 2005

Added a checkoff for contributions to the pet population control fund.

PUBLIC ACT 94-442 - EFFECTIVE: AUGUST 4, 2005

Added a checkoff for contributions to the autism research fund.

PUBLIC ACT 94-602 - EFFECTIVE: AUGUST 16, 2005

Added a checkoff for contributions to the blindness prevention fund.

PUBLIC ACT 94-73 - EFFECTIVE: JUNE 23, 2005

Added a checkoff for contributions to the epilepsy treatment and education grants-in-aid fund.

PUBLIC ACT 94-107 - EFFECTIVE: JULY 1, 2005

Added a checkoff for contributions to the diabetes research fund.

PUBLIC ACT 94-649 - EFFECTIVE: AUGUST 22, 2005

Added a checkoff for contributions to the Illinois brain tumor research fund.

PUBLIC ACT 94-142 - EFFECTIVE: JULY 8, 2005

Added a checkoff for contributions to the Vince DeMuzio memorial colon cancer fund.

PUBLIC ACT 94-141 - EFFECTIVE: JULY 8, 2005

Added a checkoff for contributions to the sarcoidosis research fund.

PUBLIC ACT 94-876 - EFFECTIVE: JUNE 19, 2006

Added a checkoff for contributions to the heartsaver AED fund.

PUBLIC ACT 94-773 - EFFECTIVE: MAY 18, 2006

Added a checkoff for contributions to the low-income energy assistance fund.

PUBLIC ACT 95-434 - EFFECTIVE: AUGUST 27, 2007

Removed all specific references to funds and replaced with general language.

PUBLIC ACT 95-435 - EFFECTIVE: AUGUST 27, 2007

Removed all specific references to funds and replaced with general language.

PUBLIC ACT 97-1117- EFFECTIVE: AUGUST 27, 2012

Added subsection designations, amended subsection (c) to exempt the Diabetes Research checkoff in Section 507GG from termination resulting from insufficient donations and added subsection (d) to exempt the Hunger Relief checkoff in Section 507SS from termination for insufficient contributions for 2012 only.

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SECTION 509.1--REMOVAL OF EXCESS CHECKOFFS

CREATED BY:

PUBLIC ACT 95-435 - EFFECTIVE: AUGUST 27, 2007

Provides for removal of all checkoffs that fail to receive $100,000 in contributions and all checkoffs in excess of 15 that were on the return in the previous year, starting with the checkoffs that received the smallest contributions.

AMENDED BY:

PUBLIC ACT 91-1117- EFFECTIVE: AUGUST 27, 2012

Amended the section to exempt the Diabetes Research checkoff in Section 507GG from the 15-fund maximum provision and to require the Hunger Relief checkoff in Section 507SS to be treated as one of the 15 qualifying funds for 2012 only.

SECTION 510--DETERMINATION OF AMOUNTS CONTRIBUTED

CREATED BY:

PUBLIC ACT 83-1412 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1984

The Department will determine the amount contributed to each of the funds and notify the State Comptroller and State Treasurer of the amounts to be transferred.

AMENDED BY:

PUBLIC ACT 84-261 - EFFECTIVE: FOR TAX YEARS ENDING ON OR BEFORE DECEMBER 31, 1985

Added transfer of funds for the Mental Health Education Fund.

PUBLIC ACT 84-324 - EFFECTIVE: FOR TAX YEARS ENDING ON OR BEFORE DECEMBER 31, 1985

Added transfer of funds for the Alzheimer's Disease Research Fund.

PUBLIC ACT 85-380 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Added transfer of funds for the United States Olympic Committee Fund.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Amended provision to state that the Department will determine the amount contributed to each fund as of October 1 of each year and will notify the State Comptroller and State Treasurer of the amount to be transferred. Also deleted the transfer of funds for the Illinois Food and Housing Assistance Fund and the Mental Health Education Fund.

PUBLIC ACT 86-678 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1989

Added the Child Abuse Prevention Fund and the Illinois Non-Game Wildlife Conservation Fund to the charities listed in the section. Deleted the United States Olympic Committee Fund.

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PUBLIC ACT 86-960 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1989

Added the Assistance to the Homeless Fund to the organizations listed in the section.

PUBLIC ACT 86-995 - EFFECTIVE: DECEMBER 13, 1989

Added the Child Care Expansion Program Fund to the organizations listed in the section.

PUBLIC ACT 86-996 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1989

Added the Community Health Center Care Fund to the organizations listed in the section.

PUBLIC ACT 87-119 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1991

Added the Persian Gulf Conflict Veterans Fund to the funds listed.

PUBLIC ACT 87-342 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1991

Added the Youth Drug Abuse Prevention Fund, the Ryan White AIDS Victims Assistance Fund, the Assistive Technology for Persons with Disabilities Fund, the Domestic Violence Shelter and Service Fund and the United States Olympians Assistance Fund to the funds listed.

PUBLIC ACT 87-992 - EFFECTIVE: SEPTEMBER 1, 1992

Added the Literacy Advancement Fund to the funds listed.

PUBLIC ACT 88-459 - EFFECTIVE: AUGUST 20, 1993

Added the Ryan White Pediatric and Adult AIDS Fund, the Illinois Special Olympics Fund, the Breast and Cervical Cancer Research Fund and the Meals on Wheels Fund to the funds listed.

PA 88-85 also added the check-off for the Breast and Cervical Cancer Research Fund.

PUBLIC ACT 88-666 - EFFECTIVE: SEPTEMBER 16, 1994

Added the Korean War Memorial Fund, the Heart Disease Treatment and Prevention Fund and the Hemophilia Treatment Fund to the funds listed.

PUBLIC ACT 89-239 - EFFECTIVE: AUGUST 4, 1995

Added check-off for the Women in Military Service Memorial Fund.

PUBLIC ACT 90-171 - EFFECTIVE: JULY 23, 1997

Added check-offs for contributions to the Mental Health Research Fund, the Children's Cancer Research Fund and the American Diabetes Association Fund.

PUBLIC ACT 91-104 - EFFECTIVE: JULY 13, 1999

Added transfer of funds for the Prostate Cancer Research Fund.

PUBLIC ACT 91-107 – EFFECTIVE: JULY 13, 1999

Changes the name of the Breast and Cervical Cancer Research Fund to the Penny Severns Breast and Cervical Cancer Research Fund.

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PUBLIC ACT 91-833 and 91-836 EFFECTIVE: JANUARY 1, 2001

Added the National World War II Memorial Fund and deleted the Women in Military Service Memorial Fund.

PUBLIC ACT 92-84 - EFFECTIVE: JULY 1, 2002

Deletes checkoffs for Community Health Center Care Fund, Heritage Preservation Fund, Child Care Expansion Program Fund, Ryan White AIDS Victims Assistance Fund, Assistive Technology for Persons with Disabilities Fund, Domestic Violence Shelter and Service Fund, United States Olympians Assistance Fund, Youth Drug Abuse Prevention Fund, Persian Gulf Conflict Veterans Fund, Literacy Advancement Fund, Ryan White Pediatric and Adult AIDS Fund, Illinois Special Olympics Fund, Korean War Memorial Fund, Heart Disease Treatment and Prevention Fund, Hemophilia Treatment Fund, Mental Health Research Fund, Children's Cancer Fund, American Diabetes Association Fund and the Meals on Wheels Fund.

PUBLIC ACT 92-198 - EFFECTIVE: AUGUST 1, 2001

Added the Korean War Veterans National Museum and Library Fund checkoff.

PUBLIC ACT 92-772 - EFFECTIVE: AUGUST 6, 2002

Added a checkoff for contributions to the Multiple Sclerosis Assistance Fund.

PUBLIC ACT 93-292 - EFFECTIVE: JULY 22, 2003

Added a checkoff for contributions to the asthma and lung research fund.

PUBLIC ACT 93-36 - EFFECTIVE: JUNE 24, 2003

Added a checkoff for contributions to the Lou Gehrig's disease research fund.

PUBLIC ACT 93-324 - EFFECTIVE: JULY 23, 2003

Added a checkoff for contributions to the Leukemia research fund.

PUBLIC ACT 93-131 - EFFECTIVE: JULY 10, 2003

Added a checkoff for contributions to the World War II Veterans Memorial fund.

PUBLIC ACT 93-776 - EFFECTIVE: JULY 21, 2004

Added a checkoff for contributions to the Illinois Veterans' home.

PUBLIC ACT 94-369 - EFFECTIVE: AUGUST 22, 2005

Added a checkoff for contributions to the pet population control fund.

PUBLIC ACT 94-442 - EFFECTIVE: AUGUST 4, 2005

Added a checkoff for contributions to the autism research fund.

PUBLIC ACT 94-602 - EFFECTIVE: AUGUST 16, 2005

Added a checkoff for contributions to the blindness prevention fund.

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PUBLIC ACT 94-073 - EFFECTIVE: JUNE 23, 2005

Added a checkoff for contributions to the epilepsy treatment and education grants-in-aid fund.

PUBLIC ACT 94-107 - EFFECTIVE: JULY 1, 2005

Added a checkoff for contributions to the diabetes research fund.

PUBLIC ACT 94-649 - EFFECTIVE: AUGUST 22, 2005

Added a checkoff for contributions to the Illinois brain tumor research fund.

PUBLIC ACT 94-142 - EFFECTIVE: JULY 8, 2005

Added a checkoff for contributions to the Vince DeMuzio memorial colon cancer fund.

PUBLIC ACT 94-141 - EFFECTIVE: JULY 8, 2005

Added a checkoff for contributions to the sarcoidosis research fund.

PUBLIC ACT 94-876 - EFFECTIVE: JUNE 19, 2006

Added a checkoff for contributions to the heartsaver AED fund.

PUBLIC ACT 94-773 - EFFECTIVE: MAY 18, 2006

Added a checkoff for contributions to the low-income energy assistance fund.

PUBLIC ACT 95-434 - EFFECTIVE: AUGUST 27, 2007

Removed all specific references to funds and replaced with general language.

PUBLIC ACT 95-435 - EFFECTIVE: AUGUST 27, 2007

Removed all specific references to funds and replaced with general language, and moved the $100,000 contribution requirement to new Section 509.1.

SECTION 511--REFUNDS

CREATED BY:

PUBLIC ACT 84-1079 - EFFECTIVE: JULY 1, 1986

The Department will provide authorization to the Comptroller to pay an individual's refund within 120 days from the date the return is received unless the Department is contesting the refund or there are no funds available.

AMENDED BY:

No amendments.

SECTION 512--SCHOOL DISTRICT INFORMATION

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CREATED BY:

PUBLIC ACT 84-1455 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

All individuals must provide school district information on their Illinois returns. (This was originally Section 508A but was renumbered by PA 85-293.)

AMENDED BY:

PUBLIC ACT 88-21 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1995.

Eliminates the requirement that the individual income tax returns contain a space for school district information. Further requires the Department to provide the State Board of Education with information on individual income tax receipts by school district from the data collected by the Geographic Information System maintained by the Department.

SECTION 514--ASSISTANCE TO THE BLIND FUND-DELETED

CREATED BY:

PUBLIC ACT 85-409 - EFFECTIVE: SEPTEMBER 15, 1987

Added a check-off of $10 or the amount of the refund on an individual return to be designated as a contribution to the Assistance to the Blind Fund.

DELETED BY:

PUBLIC ACT 86-678 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1989

SECTION 515--TRANSFER OF ASSISTANCE TO THE BLIND FUNDS-DELETED

CREATED BY:

PUBLIC ACT 85-409 - EFFECTIVE: SEPTEMBER 15, 1987

The Department shall notify the State Comptroller and State Treasurer annually of the amount, which has been designated as a contribution to the Assistance to the Blind Fund.

DELETED BY:

PUBLIC ACT 86-678 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1989

SECTION 516--ASSISTANCE TO THE HOMELESS FUND CHECK-OFF

CREATED BY:

PUBLIC ACT 86-960 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1989

Added the Assistance to the Homeless Fund to the IL-1040 as a check-off. This section contains the procedures for claiming the check-off.

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AMENDED BY:

No amendments.

SECTION 501A--ILLINOIS VETERANS HOME CHECK-OFF--DELETED

CREATED BY:

PUBLIC ACT 83-1052 - EFFECTIVE: JANUARY 5, 1984

Added a check-off for the Illinois Veterans Home Fund.

AMENDED BY:

PUBLIC ACT 84-261 - EFFECTIVE: FOR TAX YEARS ENDING ON OR BEFORE DECEMBER 31, 1985

Added provision that the check-off would be eliminated if contributions did not equal or exceed $100,000.

PUBLIC ACT 84-651 - EFFECTIVE: JANUARY 1, 1986

Substituted "Quincy" for "Illinois".

PUBLIC ACT 84-1265 - EFFECTIVE: AUGUST 11, 1986

Substituted "Illinois" for "Quincy".

DELETED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

SECTION 502A--TRANSFER OF FUNDS--DELETED

CREATED BY:

PUBLIC ACT 83-1052 - EFFECTIVE: JANUARY 5, 1984

Provided for the transfer of funds to the Illinois Veterans Home Fund.

AMENDED BY:

PUBLIC ACT 84-651 - EFFECTIVE: JANUARY 1, 1986

Substituted "Quincy" for "Illinois".

PUBLIC ACT 84-1265 - EFFECTIVE: AUGUST 11, 1986

Substituted "Illinois" for "Quincy".

DELETED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

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SECTION 508A--SCHOOL DISTRICT INFORMATION--DELETED

SEE SECTION 512

SECTION 601--PAYMENT ON DUE DATE OF RETURN

SECTION 601(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any tax shown due on the return shall be paid on or before the date fixed for filing of the return (without regard to extensions).

AMENDED BY:

PUBLIC ACT 92-826 - EFFECTIVE: AUGUST 21, 2002

Provides that if the due date for payment of a taxpayer's federal income tax is later than the due date for payment of the Illinois income tax, then the Department can prescribe a due date for payment that is not later than the due date for payment of the taxpayer's federal income tax.

SECTION 601(b)(1)--AMOUNT PAYABLE--WITHHELD TAX

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any amount that was withheld from compensation paid to an individual is considered to have been paid on account for that individual's income tax liability for the year.

AMENDED BY:

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Added reference to tax imposed by Sections 201(a) and (b) only (Income Tax).

SECTION 601(b)(2)--ESTIMATED/TENTATIVE PAYMENTS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any estimated payments paid by the taxpayer for the taxable year shall be deemed to have been paid on account of the tax imposed by this Act for such taxable year.

AMENDED BY:

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PUBLIC ACT 81-1405 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1980

Added a provision that any estimated tax paid may not be claimed on an original return filed more than 3 years after the due date provided in Section 505.

PUBLIC ACT 82-609 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1982

Added tentative payments (amounts paid pursuant to Section 602(a)) to this subsection. After the enactment of this Public Act, tentative payments and estimated payments made could not be claimed on an original return or a claim for refund filed more than 3 years after the due date provided in Section 505 (WITHOUT REGARD TO EXTENSIONS).

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Deleted the forfeiture amendments enacted by PA 81-1405 and PA 82-609. No forfeiture of estimated or tentative tax payments exists if an original return or a claim for refund is not filed within 3 years of the original due date.

The 3-year limitation on claiming estimated and tentative payments on a claim for refund (including a refund on an original return) is still in existence in Section 911(f)). Only the forfeiture of payments was eliminated.

SECTION 601(b)(3)--FOREIGN TAX

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Allows a Foreign Tax Credit to residents based on income, which is taxed by Illinois and another state.

AMENDED BY:

PUBLIC ACT 76-2403 - EFFECTIVE: JUNE 29, 1970

Added the provision that a Foreign Tax credit is not allowed if creditable tax was deducted in determining base income for the year.

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Specifies that the Foreign Tax Credit is allowed against the tax imposed by Sections 201(a) and (b) only (Income Tax).

PUBLIC ACT 83-1352 - EFFECTIVE: SEPTEMBER 8, 1984

Added the provision that no compensation received by a resident which is considered compensation paid in Illinois can qualify for the Foreign Tax Credit.

PUBLIC ACT 94-247 - EFFECTIVE: JANUARY 1, 2006

Deletes the provision in subsection (b)(3) that disallowed the foreign tax credit for taxes paid on compensation “paid in this State.”

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PUBLIC ACT 96-468 - EFFECTIVE: AUGUST 14, 2009

For tax years ending on or after December 31, 2009, limits the credit to the Illinois tax attributable to income allocable or apportionable to other states using Illinois law.

SECTION 601(b)(4)--ACCUMULATION/CAPITAL GAIN DISTRIBUTIONS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If there are amounts included in a taxpayer's base income by reason of Section 668 of the IRC (relating to accumulation distributions from a trust), the tax imposed by this Act shall be credited with his prorated share of the taxes imposed by the Act on the trust which would not have been imposed if the trust had, in fact, made distributions to its beneficiaries.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: SEPTEMBER 22, 1987

Added capital gain distribution provisions to the section.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Amended paragraph (4) to reflect changes in the IRC sections referenced and to refer to his “or her” base income.

SECTION 601.1--PAYMENTS BY ELECTRONIC FUNDS TRANSFER

CREATED BY:

PUBLIC ACT 87-1132 - EFFECTIVE: FOR LIABILITY PERIODS BEGINNING ON OR AFTER OCTOBER 1, 1993

Provides that any taxpayer (other than an individual taxpayer) that has an average monthly tax liability of $150,000 or more shall make payments by electronic funds transfer. Beginning on October 1, 1994, the average monthly liability drops to $100,000. Beginning on October 1, 1995, the average monthly liability drops to $50,000. Any taxpayer (other than an individual taxpayer) not required to transfer funds electronically may, if they so choose.

AMENDED BY:

PUBLIC ACT 87-1246 - EFFECTIVE: DECEMBER 24, 1992

Amended the electronic funds transfer section to also apply to individual taxpayers. The original monthly liability limitations were identified as relating to withholding liabilities. New quarterly liability limitations were added for estimated payment liabilities. The quarterly liabilities are:

1. $450,000 beginning October 1, 1993.
2. $300,000 beginning October 1, 1994.
3. $150,000 beginning October 1, 1995.

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The Department must notify taxpayers required to make payments by electronic funds transfer. Once notified the taxpayers must make payments by electronic funds transfer for a minimum of 1 year. The Department will determine who is required to make payments by electronic funds transfer by dividing the preceding tax year's total tax obligation by either 12 (monthly) or 4 (quarterly).

PUBLIC ACT 91-541 - EFFECTIVE: OCTOBER 1, 2000

Amended the electronic funds transfer section to require taxpayers with an average annual tax liability of $200,000 or more under Article 7 of the IITA to make all payments by electronic funds transfer. A taxpayer who has an average quarterly estimated tax payment obligation of $50,000 or more under Article 8 of this Act is required to make all payments by electronic funds transfer.

PUBLIC ACT 92-492 - EFFECTIVE: JANUARY 1, 2002

Added the sentence that “beginning on October 1, 2002, a taxpayer who has a tax liability in the amount set forth in subsection (b) of Section 2505-210 of the Department of Revenue Law shall make all payments required by rules of the Department by electronic funds transfer”. This same amendment was also enacted in Public Act 92-846.

SECTION 602--TENTATIVE PAYMENTS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The taxpayer must file a tentative tax return and pay the amount properly reportable as tax for the taxable year on or before the date for filing the return for the year without regard to extensions.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Added the statement "Pursuant to Section 505, the Department may promulgate regulations to provide automatic extensions of the time for filing a return." to Section 602(a). Also added references to the Section 1005 penalty in Section 602(b).

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deleted references to Sections 1003 and 1005 of the IITA. Added reference to the Uniform Penalty and Interest Act.

See PA 87-1189 below.

PUBLIC ACT 87-339 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1990

Added a provision that a taxpayer who is a member, or in the case of a joint return, a spouse of a member, of the US Armed Forces serving in a combat zone and subject to a filing extension in accordance with a proclamation by the President of the US pursuant to Section 7508 of the IRC, will have no interest or penalty applicable for the taxable year ending on or after December 31, 1990 during the extension period.

PUBLIC ACT 87-1189 - EFFECTIVE: September 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

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SECTION 603--CREDITS FOR UNITARY BUSINESS GROUP MEMBERS

CREATED BY:

PUBLIC ACT 83-1289 - EFFECTIVE: RETROACTIVE TO AUGUST 1, 1969

For tax years for which unitary returns were filed prior to the availability of the combined return election, a taxpayer who is a member of unitary group may elect to have any overpayment due for a taxable year credited against the liability of one or more members of the group for the taxable year. An exception applies in that when an audit has been conducted, and overpayments have been determined to be due, an overpayment of one member of the group may be applied to the liabilities of other members of the group for any year in the audit period.

AMENDED BY:

No amendments.

DELETED BY:

PUBLIC ACT 88-195 - EFFECTIVE: AUGUST 5, 1993

SECTION 604--RETURN OF PAYMENTS RECEIVED

CREATED BY:

PUBLIC ACT 86-977 - EFFECTIVE: DECEMBER 13, 1989

Any payment to the Department which is made by a check or money order not payable to the Department shall, within 15 days after receipt thereof, be returned or if the amount of payment is equal to the amount owed to the State, the Department may deposit such check.

AMENDED BY:

No amendments.

SECTION 605--PAYMENTS BY CREDIT CARD

CREATED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

The Department may adopt rules and regulations for payment of taxes due under the IITA by credit card only when the Department is not required to pay a discount fee charged by the credit card issuer.

AMENDED BY:

No amendments.

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SECTION 606--EDGE CREDITS

CREATED BY:

PUBLIC ACT 96-836 - EFFECTIVE: DECEMBER 16, 2009

Provides that EDGE credits are treated as payments of tax, rather than as a reduction of liability.

AMENDED BY:

PUBLIC ACT 96-1000 – EFFECTIVE JUNE 2, 2010.

Corrected a cross-reference to the EDGE Act.

SECTION 701--REQUIREMENT/AMOUNT OF WITHHOLDING

SECTION 701(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Every employer transacting business or maintaining an office in Illinois and is required to withhold under the IRC, is required to withhold for Illinois on compensation paid in this state. (This was originally Section 701.)

AMENDED BY:

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Changed required withholding percentage from 2.5% to rate imposed by Section 201(b). Also provided for additional withholding during the tax rate increase period to make up for the January 1 through June 30, 1983 rate increase that was unknown until July 1, 1983.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Deleted provisions related to temporary tax rate increase.

SECTION 701(b)--PAYMENTS TO RESIDENTS

CREATED BY:

PUBLIC ACT 77-583 - EFFECTIVE: JANUARY 1, 1972

Any payment by an Illinois payor to an Illinois resident is considered compensation paid in this state.

AMENDED BY:

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Provides that any payment to a resident by a payor maintaining an office or transacting business

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within this state will also include any agency, officer, or employee of this State or of any political subdivision of this State.

PUBLIC ACT 93-634 - EFFECTIVE: DECEMBER 26, 2003

Allows IDES to enter into voluntary withholding agreements with unemployment insurance recipients.

PUBLIC ACT 98-496 - EFFECTIVE: AUGUST 16, 2013

Added language excluding payments subject to withholding under Section 710 from this provision.

SECTION 701(c)--PAYMENTS TO NONRESIDENTS--DELETED

CREATED BY:

PUBLIC ACT 80-580 - EFFECTIVE: SEPTEMBER 12, 1977

Any payment of capital gains, rents, royalties, prizes and awards paid to a nonresident of this state by a payor within Illinois, is considered compensation paid in this state for withholding purposes.

AMENDED BY:

PUBLIC ACT 80-1516 - EFFECTIVE: JANUARY 12, 1979

Added, "commencing on January 1, 1980..." to subsection.

DELETED BY:

PUBLIC ACT 81-221 - EFFECTIVE: JANUARY 1, 1980

SECTION 701(c)--SPECIAL DEFINITIONS

CREATED BY:

PUBLIC ACT 77-583 - EFFECTIVE: JANUARY 1, 1972

The term "employer" includes any payor who is required to withhold tax pursuant to Section 701.

AMENDED BY:

No amendments.

SECTION 701(d)--RECIPROCAL EXEMPTION

CREATED BY:

PUBLIC ACT 76-2404 - EFFECTIVE: JUNE 29, 1970

If the Director enters into a written agreement with any state which imposes a tax on or measured by net income to provide that compensation paid in such state to residents of Illinois shall be exempt

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from the tax in such state, any compensation paid in Illinois to a resident of such state will be exempt from withholding in Illinois.

AMENDED BY:

PUBLIC ACT 90-491 - EFFECTIVE: JANUARY 1, 1998

All reciprocal agreements are subject to the requirements of Section 39b53 of the Civil Administrative Code of Illinois.

SECTION 701(e)--NO WITHHOLDING REQUIRED

CREATED BY:

PUBLIC ACT 83-34 - EFFECTIVE: JULY 27, 1983

No withholding is required on payments for which withholding is required under Sections 3402, 3405 and 3451 of the IRC.

AMENDED BY:

PUBLIC ACT 83-961 - EFFECTIVE: DECEMBER 2, 1983

Deleted reference to Section 3402 and 3451 of the IRC and added reference to Section 3406 of the IRC.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Deleted extraneous language in reference to the IRC.

SECTION 702--AMOUNT EXEMPT FROM WITHHOLDING

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Described procedures for computing the amount of Illinois compensation, which is exempt from withholding.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Rewrote provision for computing the amount of Illinois compensation, which is exempt from withholding.

PUBLIC ACT 90-613 - EFFECTIVE: JULY 9, 1998

Changed the amount of Illinois compensation exempt from withholding to be equal to the basic amount detailed Section 204(b).

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

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Deleted extraneous language in reference to the IRC.

SECTION 703--INFORMATION STATEMENT

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Requires every employer to notify employees (by January 31 of the succeeding year) of the amount withheld for the year.

AMENDED BY:

PUBLIC ACT 91-841 - EFFECTIVE: JUNE 22, 2000

Requires the employer to state on an employee's withholding information statement (Form W-2) the tax-exempt amount contributed to a medical savings account.

PUBLIC ACT 97-0507-EFFECTIVE: AUGUST 23, 2011

Deleted provision requiring medical savings account information to be provided on the Form W-2.

SECTION 703A--INFORMATION FOR REPORTABLE PAYMENT TRANSACTIONS

CREATED BY:

PUBLIC ACT 100-1171 - EFFECTIVE: JANUARY 4, 2019

Requires every person required to file a Form 1099-K report of credit card payments to file a copy with the IDOR at the time and in the manner required by the IDORs.

SECTION 704--EMPLOYER'S RETURN/PAYMENT OF TAX WITHHELD

SECTION 704(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Every employer who withholds tax is required to pay such tax to Illinois. (This was originally Section 704.)

AMENDED BY:

PUBLIC ACT 77-627 - EFFECTIVE: AUGUST 4, 1971

Added statement that all taxes withheld and not previously paid to the Department or to a depository designated by the Department, should be paid at the end of each quarter and at the end of the year. (This amendment was later incorporated into Section 704(b).)

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PUBLIC ACT 82-1009 - EFFECTIVE: SEPTEMBER 17, 1982

Added statement "Every employer who deducts and withholds or is required to deduct and withhold..."

PUBLIC ACT 95-008 - EFFECTIVE: JUNE 29, 2007

Provides that this section applies only prior to January 1, 2008.

SECTION 704(b)--QUARTER-MONTHLY PAYMENTS: RETURNS

CREATED BY:

PUBLIC ACT 79-6thSS-3 - EFFECTIVE: TAXES WITHHELD AFTER OCTOBER 1, 1976

Required that quarter-monthly payments of taxes withheld should be made if the aggregate amount withheld exceeds $500.

AMENDED BY:

PUBLIC ACT 82-1009 - EFFECTIVE: SEPTEMBER 17, 1982

Added statement "Every employer who deducts and withholds or is required to deduct and withhold..."

PUBLIC ACT 84-341 - EFFECTIVE: JANUARY 1, 1986

Raised threshold for quarter-monthly payments to $1000.

SECTION 704(c)--MONTHLY PAYMENTS: RETURNS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Requires that monthly payments of the amount of tax withheld should be made if the aggregate amount withheld and not paid to the Department exceeds $100 but does not exceed $500. (This was originally part of Section 704.)

AMENDED BY:

PUBLIC ACT 84-341 - EFFECTIVE: JANUARY 1, 1986

Raised threshold for monthly payments to $500 not to exceed $1000.

SECTION 704(d)--ANNUAL PAYMENTS: RETURNS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

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Allows employers who withhold less than $100 a year to file and pay the amount withheld on an annual return.

AMENDED BY:

PUBLIC ACT 84-341 - EFFECTIVE: JANUARY 1, 1986

Raised threshold for annual filers to employers who withhold less than $500.

SECTION 704(e)--ANNUAL RETURN

CREATED BY:

PUBLIC ACT 79-6thSS-3 - EFFECTIVE: TAXES WITHHELD AFTER OCTOBER 1, 1976

The Department may prescribe for the filing of annual returns instead of quarterly returns.

AMENDED BY:

PUBLIC ACT 90-374 - EFFECTIVE: AUGUST 14, 1997

Allows annual withholding returns to be filed for tax withheld from a domestic service employee.

PUBLIC ACT 90-562 - EFFECTIVE: AUGUST 14, 1997

Rewrites the amendments contained in PA 90-374. Allows annual withholding returns to be filed for tax withheld from a domestic service employee and the tax paid on an annual basis by the 15th day of the 4th month following the close of the taxpayer's year. The return may be submitted with the employer's individual income tax return.

SECTION 704(f)--MAGNETIC MEDIA FILING

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JULY 1, 1992

Allows the Department to require W-2's to be filed on magnetic media if they are required to be filed with the IRS on magnetic media.

SECTION 704A--WITHHOLDING

CREATED BY:

PUBLIC ACT 95-008 - EFFECTIVE: JUNE 29, 2007

Added this section for withholding required on or after January 1, 2008.

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AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Corrected a typographical error in Section 704A(b).

PUBLIC ACT 96-834 - EFFECTIVE: DECEMBER 14, 2009

Adds subsection (g) to allow qualifying automotive industry taxpayers to use their EDGE credits against their withholding obligations, beginning in 2010.

PUBLIC ACT 96-0888 -- EFFECTIVE: APRIL 13, 2010

Adds subsection (h) to all the Small Business Job Creation Tax Credit to be claimed against withholding.

PUBLIC ACT 96-0905 -- EFFECTIVE: JUNE 4, 2010

Amends subsection (g) to expand the class of taxpayers who may use their EDGE credits against their withholding obligations.

PUBLIC ACT 96-1027- EFFECTIVE: JULY 12, 2010

Amends subsection (c)(1) to require electronic payment by semi-weekly depositors beginning in 2011 and corrects subsection (d)(1) to permit the Department to allow annual filing of wage withholding returns without regard to the amount withheld by the employer.

PUBLIC ACT 97-0033- EFFECTIVE: AUGUST 12, 2011

Corrected (c)(1) language added by Public Act 96-1027 to say “payments” rather than “payment”.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Amended subsection (h) to add a missing “the” before “date”.

PUBLIC ACT 100-303 EFFECTIVE: AUGUST 24, 2017

Amended subsection (f) to allow the Department to require electronic filing of withholding returns and W-2 information and to set the due date for filing.

PUBLIC ACT 100-511 EFFECTIVE: SEPTEMBER 18, 2017

Amended subsection (g) to reflect the repeal of DCEO authority to enter agreements allowing the EDGE credit to be claimed against withholding.

PUBLIC ACT 100-863 – EFFECTIVE: AUGUST 14, 2018

Reconciled the amendments made in Public Act 100-303 and Public Act 100-511.

PUBLIC ACT 101-1 – EFFECTIVE: FEBRUARY 19, 2019

Added subsection (i) to provide for the minimum wage credit.

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SECTION 705--EMPLOYER'S LIABILITY FOR WITHHELD TAXES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any amount withheld by an employer is considered to be held in a special trust for the Department however it is considered tax of the employer.

AMENDED BY:

PUBLIC ACT 82-1009 - EFFECTIVE: SEPTEMBER 17, 1982

Added statement "Every employer who deducts and withholds or is required to deduct and withhold..."

SECTION 706--EMPLOYER'S FAILURE TO WITHHOLD

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If an employer fails to withhold tax, any amount of tax subsequently assessed is not collected from the employer. The employer is however, liable for any penalties and interest assessed for not properly withholding.

AMENDED BY:

No amendments.

SECTION 707--GOVERNMENTAL EMPLOYERS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If the employer is governmental, any officer or employee having control of the payment may pay the amount withheld.

AMENDED BY:

No amendments.

SECTION 708--WITHHOLDING-PERSONAL SERVICE CONTRACTS--DELETED

CREATED BY:

PUBLIC ACT 81-221 - EFFECTIVE: JANUARY 1, 1980

This section contained the procedures for withholding taxes on personal service contracts.

AMENDED BY:

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PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Deleted statement from Section 708(a) regarding that withholding should occur at a rate of 2.5% and added that withholding should occur at the percentage rate provided in Section 201(b). Also added subsection (b)(3) dealing with the temporary tax rate increase.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Deleted subsection (b)(3) regarding the temporary tax rate increase.

DELETED BY:

PUBLIC ACT 85-299 - EFFECTIVE: JANUARY 1, 1989

SECTION 709--WITHHOLDING-PRIZES AND AWARDS--DELETED

CREATED BY:

PUBLIC ACT 81-221 - EFFECTIVE: JANUARY 1, 1980

This section contained the procedures for withholding taxes on payments of prizes and awards in excess of $1000 that were awarded to nonresidents.

AMENDED BY:

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Deleted statement from Section 709(a) regarding that withholding should occur at a rate of 2.5% and added that withholding should occur at the percentage rate provided in Section 201(b). Also added subsection (a)(3) dealing with the temporary tax rate increase.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Deleted subsection (a)(3) regarding the temporary tax rate increase.

DELETED BY:

PUBLIC ACT 85-299 - EFFECTIVE: JANUARY 1, 1989

SECTION 709.5--WITHHOLDING BY PASS-THROUGH ENTITIES

CREATED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Added this section for to require withholding from income earned in taxable years ending on or after December 31, 2008.

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AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Amended (a) to provide that investment partnerships are not required to withhold and that no withholding is required from exempt organizations, amended subsection (b) to clarify that pass-through entities from which tax was withheld could pass the withholding through to their owners, and added new subsection (c) to provide that no withholding is required from nonresidents (other than individuals) who have provided the pass-through entity with a valid certificate promising to pay their Illinois liabilities.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Amended (a) to exempt from withholding tax-exempt payments to retired partners.

PUBLIC ACT 98-478 - EFFECTIVE: AUGUST 16, 2013

Provides that, for tax years ending on or after December 31, 2014, pass-through withholding must be paid on nonbusiness income sourced to Illinois and is net of credits that flow through to the owner.

PUBLIC ACT 100-201 - EFFECTIVE: AUGUST 18, 2017

Corrects a typographical error in subsection (c)(4).

SECTION 710--WITHHOLDING FROM LOTTERY WINNINGS

CREATED BY:

PUBLIC ACT 81-221 - EFFECTIVE: JANUARY 1, 1980

This section contained the procedures for withholding taxes on lottery winnings.

AMENDED BY:

PUBLIC ACT 81-1424 - EFFECTIVE: AUGUST 29, 1980

Amended section to apply only to lottery winnings in excess of $1000.

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Deleted statement regarding that withholding should occur at a rate of 2.5% and added that withholding should occur at the percentage rate provided in Section 201(b). Also added provisions dealing with the temporary tax rate increase.

PUBLIC ACT 83-581 - EFFECTIVE: SEPTEMBER 17, 1983

Amended section to state that withholding applies to any person making a payment to a resident or nonresident.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Deleted provisions regarding the temporary tax rate increase.

PUBLIC ACT 98-496 - EFFECTIVE: AUGUST 16, 2013

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Added (a)(2) to require withholding from the purchase price for lottery winnings paid after December 31, 2013.

PUBLIC ACT 101-10 - EFFECTIVE: JUNE 5, 2019

Added (a)(2) to require withholding from winnings at Illinois race tracks and casinos.

SECTION 711--PAYOR'S RETURN/PAYMENT OF TAX WITHHELD

CREATED BY:

PUBLIC ACT 81-221 - EFFECTIVE: JANUARY 1, 1980

This section contained the reporting procedures for persons withholding under Sections 708, 709 and 710.

AMENDED BY:

PUBLIC ACT 84-127 - EFFECTIVE: AUGUST 1, 1985

Rewrote Section 711(a).

PUBLIC ACT 85-299 - EFFECTIVE: JANUARY 1, 1989

Deleted all references to Sections 708 and 709.

PUBLIC ACT 85-982 - EFFECTIVE: DECEMBER 16, 1987

Imposes same liability and reporting requirements on payors required to withhold under Sections 708 and 709 as are imposed on payors required to withhold under Section 710 until January 1, 1989.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Added this new subsection (a-5) to provide the due date for payment of withholding by pass-through entities under Section 709.5, and amended subsection (b) to add cross-references to Section 709.5 and delete obsolete cross-references.

SECTION 712--PAYOR'S LIABILITY FOR WITHHELD TAXES

CREATED BY:

PUBLIC ACT 81-221 - EFFECTIVE: JANUARY 1, 1980

Persons required to withhold taxes under Sections 708, 709 and 710 are liable for the tax withheld.

AMENDED BY:

PUBLIC ACT 82-1009 - EFFECTIVE: SEPTEMBER 17, 1982

Added statement "Every employer who deducts and withholds or is required to deduct and withhold..."

PUBLIC ACT 85-299 - EFFECTIVE: JANUARY 1, 1989

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Deleted all references to Sections 708 and 709.

PUBLIC ACT 85-982 - EFFECTIVE: DECEMBER 16, 1987

Imposes same liability and reporting requirements on payors required to withhold under Sections 708 and 709 as are imposed on payors required to withhold under Section 710 until January 1, 1989.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this section to add cross-references to Section 709.5 and delete obsolete cross-references.

SECTION 713--PAYOR'S FAILURE TO WITHHOLD

CREATED BY:

PUBLIC ACT 81-221 - EFFECTIVE: JANUARY 1, 1980

If any person fails to withhold taxes as required under Sections 708, 709 or 710 and the taxes are subsequently assessed; the payor is not liable for the taxes. The payor is however liable for any penalties or interest which apply to the failure to properly withhold.

AMENDED BY:

PUBLIC ACT 85-299 - EFFECTIVE: JANUARY 1, 1989

Deleted all references to Sections 708 and 709.

PUBLIC ACT 85-982 - EFFECTIVE: DECEMBER 16, 1987

Imposes same liability and reporting requirements on payors required to withhold under Sections 708 and 709 as are imposed on payors required to withhold under Section 710 until January 1, 1989.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this section to add cross-references to Section 709.5 and delete obsolete cross-references.

SECTION 801--DECLARATION OF ESTIMATED TAX--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contained the provisions for filing a declaration of estimated tax by any taxpayer other than an estate or trust if the amount payable as estimated tax could reasonably be expected to exceed $50. The section also contained a definition of estimated tax, discussed joint declarations, amended declarations and applicability of short taxable years.

AMENDED BY:

PUBLIC ACT 76-2587 - EFFECTIVE: AUGUST 8, 1970

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Added subsection (f), which stated that a return filed before January 15 of the succeeding year would serve as a declaration.

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Amended section to include partnerships and Subchapter S corporations.

DELETED BY:

PUBLIC ACT 84-127 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

Portions of this section were incorporated into Section 803.

SECTION 802--TIME FOR FILING DECLARATIONS--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contained the provisions for when the declaration of estimated tax must be filed.

AMENDED BY:

PUBLIC ACT 77-627 - EFFECTIVE: AUGUST 4, 1971

Amended subsection (b) which related to farmers stating that an individual having estimated gross income (rather than Illinois base income) from farming of at least 2/3 of the total estimated gross income (rather than Illinois base income) for such year, may file a declaration on or before January 15 of the succeeding year.

DELETED BY:

PUBLIC ACT 84-127 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

Portions of this section were incorporated into Section 803.

SECTION 803--PAYMENT OF ESTIMATED TAX

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains provisions for the payment of estimated tax.

AMENDED BY:

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Added new subsection (b), which related to the temporary tax rate increase and the filing of amended declarations.

PUBLIC ACT 84-127 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

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Rewrote Section 803 and incorporated portions of Sections 801 and 802 regarding the definition of estimated tax and the installment payment due dates. All references to the declaration for estimated tax were deleted from Section 803. The tax liability requirement for making estimated payments was increased from $50 to $250.

PUBLIC ACT 84-1400 - EFFECTIVE: SEPTEMBER 18, 1986

Amended subsection (e) to allow taxpayers with 2/3 of their income from farming to file and pay estimated tax by March 1.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Amended subsection (e) to read that individuals with gross income (rather than estimated gross income) from farming which is at least 2/3 of the total estimated gross income are allowed the special provisions for farmers.

PUBLIC ACT 86-678 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1990

Amended subsection to state that farmers are not required to make estimated payments. The tax liability requirement for making estimated payments was increased from $250 to $400 for corporations only. Only the definition of a farmer remains in subsection (e).

PUBLIC ACT 91-913 - EFFECTIVE: JANUARY 1, 2001

Provides that the tax liability requirement for making estimated payments is increased from $250 to $500 for individuals for tax years ending on or after December 31, 2001.

PUBLIC ACT 101-355 - EFFECTIVE: AUGUST 9, 2019

Raised the threshold for individuals from $500 to $1000.

SECTION 804--FAILURE TO PAY ESTIMATED TAX

SECTION 804(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any person who underpays their estimated tax liability (unless one of the exceptions of subsection (d) applies) is also liable for a penalty of 10% per annum on the amount of the underpayment for the period of the underpayment.

AMENDED BY:

PUBLIC ACT 83-581 - EFFECTIVE: SEPTEMBER 17, 1983

Increased penalty from 10% per annum to 24% per annum.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Added reference to subsection (e).

PUBLIC ACT 86-678 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1990

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The tax liability requirement for making estimated payments (for corporations only) was increased from $250 to $400.

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deleted reference to subsection (f). Deleted rate information. Changed the computation of the penalty from a per annum basis to a flat rate. Added reference to the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: September 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 804(b)--AMOUNT OF UNDERPAYMENT

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section defines the amount of the underpayment as the amount of the installment which would be required to be paid if the estimated tax were equal to 80% of the tax shown on the return (or 80% of the tax required to be shown on the return in the case of a nonfiler) less the amount paid.

AMENDED BY:

PUBLIC ACT 86-678 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1990

The amount of underpayment was amended to be the excess of the amount of the installment required to be paid under subsection (d) less any amount paid on or before the date prescribed for payment.

PUBLIC ACT 96-1496- EFFECTIVE: JANUARY 13, 2011

Added (b)(1)(iii) to increase the safe harbor from 100% of the prior year's tax to 150% from installments due between February 1, 2011, and February 1, 2012.

SECTION 804(c)--PERIOD OF UNDERPAYMENT--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section defines the period of underpayment as the date the installment was due to the earlier of the 15th day of the fourth month following the close of the taxable year or the date on which any portion of the installment was paid (in respect to that portion of the installment only).

AMENDED BY:

PUBLIC ACT 81-1405 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1980

Amended subsection (c)(1) to read "The due date of the taxpayer's return as provided in Section 505 (without regard to any extensions)." rather than "The 15th day of the fourth month..."

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PUBLIC ACT 84-127 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

Rewrote subsection (c)(2). Previously a payment of estimated tax was credited against any prior unpaid installment only to the extent that the payment exceeded the current installment due. Based on this public act, a payment of estimated tax is now credited against any unpaid installment in the order in which such installments were required to be paid.

DELETED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Penalty is no longer computed on the period of the underpayment.

PUBLIC ACT 87-1189 - EFFECTIVE: September 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 804(c)--AMOUNT OF REQUIRED INSTALLMENTS

CREATED BY:

PUBLIC ACT 86-678 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1990

This subsection now contains the new procedures for determining the proper amount of installment, which is required to be paid in each quarter. The exceptions of the old subsection (d)(1) and (d)(3) were incorporated into the new subsection (d) and the exception contained in the old subsection (d)(2) was eliminated for corporations and moved to subsection (e) for individuals. The required installment is 25% of the required annual payment. The required annual payment is defined in subparagraph (B). (Subsections of (B) are identified in parenthesis):

* 90% of the tax shown on the return or required to be shown on the return, if no return was filed-- (i).
* 100% of the tax shown on the previous year's return if the previous year's return reflected a liability and was for a 12 month period-- (ii).

Subsection (2) also allows for annualization of income.

AMENDED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Re-lettered this subsection from (d) to (c).

PUBLIC ACT 87-1189 - EFFECTIVE: September 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

PUBLIC ACT 96-1496- EFFECTIVE: JANUARY 13, 2011

Amended subsection (c)(1)(B)(ii) to state “for installments due prior to February 1, 2011, and after January 31, 2012”. Added subsection (c)(1)(B)(iii) which states “for installments due after January 31, 2011, and prior to February 1, 2012, 150% of the tax shown on the return of the taxpayer for the

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preceding taxable year if a return showing a liability for tax was filed by the taxpayer for the preceding taxable year and such preceding year was a taxable year of 12 months".

PUBLIC ACT 97-636-EFFECTIVE: DECEMBER 16, 2011

Added new paragraph (3) to require a higher safe harbor for federally-regulated exchanges for installments due in the first fiscal year for which the election to apply IITA Section 304(c-1) applies.

SECTION 804(d)--EXCEPTION--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section provides certain exceptions to the Section 804 penalty including estimated payments, which total (subparagraphs of Section 804(d) are identified):

* 100% of the previous year's tax liability-- (1).
* Estimated payments which equal what the tax liability on the previous year's return would be based on this year's rate and last year's facts-- (2) for corporations, (6) for individuals.
* 80% of the annualized income (66 2/3% for farmers)--(3) for corporations, (4) for individuals.
* 90% of actual income for the months up to the installment date (for individuals only)--(5).

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Amended Section 804(d) to state that no Section 804 penalty will be imposed if the taxpayer was not required to file an Illinois Income Tax return for the preceding taxable year.

DELETED BY:

PUBLIC ACT 86-678 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1990

Amended Section 804(d) to define the amount of required installments rather than the exceptions to the penalty. See below.

SECTION 804(d)--EXCEPTIONS

CREATED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

The Section 804 penalty can be abated if the imposition of the penalty "would be against equity and good conscience."

AMENDED BY:

PUBLIC ACT 86-678 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1990

Rewrote Section 804(e) to provide for exceptions to the Section 804 penalty if the taxpayer was not required to file a return for the preceding year or, for individuals only, if the taxpayer had no liability for

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the preceding year and the return for the preceding year was for a period of 12 months. (The reasonable cause abatement of penalty was moved to Section 804(f)).

PUBLIC ACT 86-95 - EFFECTIVE: NOVEMBER 30, 1989

The Section 804 penalty will not be imposed if the taxpayer has underpaid taxes solely because of the increased rate in effect during the period from July 1, 1989 through December 1989.

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Re-lettered this subsection from (e) to (d).

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

PUBLIC ACT 90-613 - EFFECTIVE: JULY 9, 1998

Eliminated the exception for the taxpayer that underpaid taxes solely because of the increased rate in effect during the period from July 1, 1989 through December 1989.

Added the exception for underpayments of estimated tax due before the effective date of this amendatory act of 1998 which underpayments are solely attributable to the change in apportionment from Section 304(a) to (h), single factor sales apportionment formula. The provisions of this amendatory Act of 1998 apply to tax years ending on or after December 31, 1998.

SECTION 804(e)--ABATEMENT OF THE PENALTY

CREATED BY:

PUBLIC ACT 86-678 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1990

The reasonable cause abatement previously contained in old subsection (e) was moved to new subsection (f).

AMENDED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Re-lettered this subsection from (f) to (e). Deleted the effective date language of PA 85-731. Deleted the reasonable cause abatement language and added a reference to the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subsection to change the reference to the “Department” to the “Director” or a delegate.

SECTION 804(f)--DEFINITION OF TAX

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CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

For purposes of this section "tax" means the excess of the tax imposed by the IITA over any tax credited by Sections 601(b)(3) and (4).

AMENDED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Re-lettered this subsection from (g) to (f).

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 804(g)--APPLICATION AGAINST TAX WITHHELD

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Tax withheld is considered an estimated payment of tax with an equal part being deemed paid on each installment date unless the taxpayer identifies when the withholding actually occurred.

AMENDED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Re-lettered this subsection from (h) to (g).

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

PUBLIC ACT 90-448 - EFFECTIVE: AUGUST 16, 1997

Allows individuals that have amounts withheld under the State Salary and Annuity Withholding Act to elect to have those amounts treated as estimated payments as of the date the amounts are actually withheld.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subsection to add provisions for withholding by pass-through entities under Section 709.5.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Amended paragraph (l) to delete language applying its provisions only to individuals.

SECTION 804(h)--PRE 8/1/70 YEARS--DELETED

CREATED BY:

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PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Section 804 does not apply to tax years beginning prior to August 1, 1970.

DELETED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

SECTION 804(i)--SHORT TAXABLE YEARS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The Department will develop regulations to apply Section 804 to short taxable years. (To date no such regulations have been developed.)

AMENDED BY:

No amendments.

SECTION 805--DECLARATION AS RETURN--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The provisions of Sections 502, 503, 504, 505 and 917 apply to the required declaration of estimated tax.

DELETED BY:

PUBLIC ACT 84-127 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

SECTION 806--EXEMPTION FROM PENALTY

CREATED BY:

PUBLIC ACT 90-491 - EFFECTIVE: JANUARY 1, 1998

Creates an exemption from the estimated payment penalty for taxpayers over 64 years of age whom are permanent residents of a nursing home.

AMENDED BY:

PUBLIC ACT 96-339 - EFFECTIVE: JULY 1, 2010

Added reference to MR/DD Community Care Act.

PUBLIC ACT 97-0038- EFFECTIVE: JUNE 28, 2011

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Added reference to Specialized Mental Health Rehabilitation Act.

PUBLIC ACT 97-0227- EFFECTIVE: JULY 28, 2011

Changed reference to “MR/DD” Community Care Act to say “ID/DD”.

PUBLIC ACT 98-104 - EFFECTIVE: JULY 22, 2013

Added reference to “of 2013.”

PUBLIC ACT 99-180 - EFFECTIVE: JULY 29, 2015

Added reference to the MC/DD Act.

SECTION 807--EDGE CREDITS

CREATED BY:

PUBLIC ACT 96-836 - EFFECTIVE: DECEMBER 16, 2009

Provides that EDGE credits are treated as payments of tax, rather than as a reduction of liability.

AMENDED BY:

PUBLIC ACT 96-1000 – EFFECTIVE JUNE 2, 2010.

Corrected a cross-reference to the EDGE Act.

SECTION 901--COLLECTION AUTHORITY

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The Department will collect the taxes imposed by the IITA and shall pay all moneys into the General Revenue Fund. Each month the Treasurer shall transfer 1/12 on the money imposed by the IITA into the Local Government Distributive Fund.

AMENDED BY:

PUBLIC ACT 76-2587 - EFFECTIVE: AUGUST 8, 1970

Added definition of net revenue realized for the month to Section 901(b).

PUBLIC ACT 81-1stSS-1 - EFFECTIVE: SEPTEMBER 19, 1979

Added references to Replacement Tax provisions to Section 901(b).

PUBLIC ACT 81-1255 - EFFECTIVE: JUNE 26, 1980

Amended Section 901(a) to exclude money collected as a result of the Replacement Tax provisions from being paid into the General Revenue Fund and to provide that this money should be paid into the Personal Property Tax Replacement Fund.

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PUBLIC ACT 85-1414 - EFFECTIVE: NOVEMBER 29, 1988

Added subsections (c) and (d), creating the Income Tax Refund Fund and the Personal Property Tax Replacement Tax Replacement Fund, and providing for deposits into and transfers from these funds and payments of refunds from the balance.

PUBLIC ACT 86-18 - EFFECTIVE: JULY 5, 1989

Amended subsection (b) to state that a portion of the money deposited into the General Fund, the Education Assistance Fund and the Income Tax Surcharge Local Government Distributive Fund should be transferred to the Local Government Distributive Fund. Also created subsection (e) which discusses the deposits into the Education Assistance Fund and the Income Tax Surcharge Local Government Distributive Fund and their relationship to the temporary tax rate increase for the period of July 1, 1989 to June 30, 1991.

PUBLIC ACT 87-17 - EFFECTIVE: RETROACTIVE TO JULY 1, 1991

Deleted the old subsection (e) and replaced it with the new deposit procedures for tax revenues.

PUBLIC ACT 87-860 - EFFECTIVE: JULY 1, 1992

Amended subsection (e) to change the deposit procedures for Income Tax revenues.

PUBLIC ACT 88-89 - EFFECTIVE: JULY 1, 1993

Amended subsections (b) and (e) to change the deposit procedures for Income Tax revenues.

PUBLIC ACT 90-613 - EFFECTIVE: JULY 9, 1998

Amended Section 901(c) to change the deposit percentage into the Income Tax Refund Fund. Also, amended 901(d) to reflect changes in the transfer procedures between the Income Tax Refund Fund and the Personal Property Tax Replacement Fund, and to require transfers of year-end surpluses in the Income Tax Refund Fund to the General Revenue Fund.

PUBLIC ACT 91-700 - EFFECTIVE: MAY 11, 2000

Adds Section 901(c)(3), which provides that the Treasurer shall transfer from the Tobacco Settlement Recovery Fund to the Income Tax Refund Fund: (1) $35 million in January 2001; (2) $35 million in January 2002; and (3) $35 million in January 2003.

Amended Section 901(d)(2) to add a reference to Section 901(c)(3).

Amended Section 901(d)(4.5) to provide exclusion for amounts transferred under Section 901(c)(3) less refunds resulting from the earned income tax credit for fiscal years 2000, 2001, and 2002.

PUBLIC ACT 91-704 - EFFECTIVE: JULY 1, 2000

Amends Section 901(d), by providing that beginning January 1, 1998, money in the Income Tax Refund Fund shall be expended also for paying rebates under Section 208.1 in the event that the amounts in the Homeowners' Tax Relief Fund are insufficient for that purpose.

PUBLIC ACT 91-712 - EFFECTIVE: JULY 1, 2000

Amends Section 901(a), by providing that money collected under 20 ILCS Section 2505-650 of the

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Department of Revenue Law shall be paid into the Child Support Enforcement Trust Fund.

PUBLIC ACT 92-11 - EFFECTIVE: JUNE 11, 2001

Amends Section 901(c)(1), by providing that deposits into the Income Tax Refund Fund will be minus the amounts transferred from the Tobacco Settlement Recovery Fund.

Amends Section 901(c)(2) by providing that in State fiscal year 2002, the Annual Percentage shall not exceed 23%.

PUBLIC ACT 92-600 - EFFECTIVE: JUNE 28, 2002

Amends Section 901(c)(1), by providing that the annual rate for deposits into the Income Tax Refund Fund will be 8% for fiscal year 2003.

Amends Section 901(c)(2), by providing that the annual rate for deposits into the Income Tax Refund Fund will be 27% for fiscal year 2003.

PUBLIC ACT 93-32 - EFFECTIVE: JUNE 20, 2003

Amends Section 901(b) to reduce transfers to the local government by $6,666,666 for fiscal year 2004, amends Section 901(c)(1) to raise contributions to the refund fund to 11.7% for fiscal 2004 and amends Section 901(c)(2) to raise contributions to the replacement tax refund fund to 32% for fiscal 2004.

PUBLIC ACT 93-839 - EFFECTIVE: JULY 30, 2004

Amends Section 901(c)(1) to reduce contributions to the refund fund to 10% for fiscal 2005 and amends Section 901(c)(2) to reduce contributions to the replacement tax refund fund to 24% for fiscal 2005.

PUBLIC ACT 94-81 - EFFECTIVE: JULY 1, 2005

Changed the reference in (a) from Public Aid to Healthcare and Family Services. Amends Section 901(c)(1) to reduce contributions to the refund fund to 9.75% for fiscal 2007 and amends Section 901(c)(2) to reduce contributions to the replacement tax refund fund to 20% for fiscal 2007.

PUBLIC ACT 94-839 - EFFECTIVE: JUNE 6, 2006

Changed the reference in (a) from Public Aid to Healthcare and Family Services. Amends Section 901(c)(1) to keep contributions to the refund fund at 9.75% for fiscal 2007 and amends Section 901(c)(2) to reduce contributions to the replacement tax refund fund to 17.5% for fiscal 2007.

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Amends Section 901(c)(1) to reduce contributions to the refund fund to 7.75% for fiscal 2008 and amends Section 901(c)(2) to reduce contributions to the replacement tax refund fund to 15.5% for fiscal 2008.

PUBLIC ACT 95-744 - EFFECTIVE JULY 18, 2008

Amends Section 901(c)(1) to increase contributions to the refund fund to 9.75% for fiscal 2009 and amends Section 901(c)(2) to reduce contributions to the replacement tax refund fund to 17.5% for fiscal 2009.

PUBLIC ACT 96-45 - EFFECTIVE: JULY 15, 2009

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Amends Section 901(b) to correct reference to “Local Government” rather than “Local Governmental,” Section 901(c)(1) to extend the 9.75% rate for contributions to the refund fund to fiscal 2010 and amends Section 901(c)(2) to extend the 17.5% rate for contributions to the refund fund to fiscal 2010.

PUBLIC ACT 96-328 - EFFECTIVE: AUGUST 11, 2009

Amends Section 901(b) to correct reference to “Local Government” rather than “Local Governmental.”

PUBLIC ACT 96-0959 - EFFECTIVE: JULY 12, 2010

Amends Section 901(c)(1) to decrease contributions to the refund fund to 8.75% for fiscal 2011 and amends Section 901(c)(2) to extend the 17.5% rate for contributions to the replacement tax refund fund to fiscal 2011.

PUBLIC ACT 96-1496- EFFECTIVE: JANUARY 13, 2011

Amended subsection (b) to adjust the deposits into the Local Government Distributive Fund to all revenues from the rate changes enacted in this act to go to the State. Added subsections (f) and (g) to provide for deposits into the Fund for Advancement of Education and the Commitment to Human Services Fund, respectively.

PUBLIC ACT 97-0072- EFFECTIVE: JUNE 30, 2011

Amends Section 901(c)(1) to extend the 8.75% rate for contributions to the refund fund to fiscal 2012 and amends Section 901(c)(2) to extend the 17.5% rate for contributions to the replacement tax refund fund to fiscal 2012.

PUBLIC ACT 97-732- EFFECTIVE: JUNE 30, 2012

Amends Section 901(c)(1) to extend a 9.75% rate for contributions to the refund fund to fiscal 2013, and amends Section 901(c)(2) to extend the 14% rate for contributions to the replacement tax refund fund to fiscal 2013.

PUBLIC ACT 98-24 - EFFECTIVE: JUNE 19, 2013

Amends Section 901(c)(1) to provide a 9.5% rate for contributions to the refund fund in fiscal 2014 and amends Section 901(c)(2) to provide a 13.4% rate for contributions to the replacement tax refund fund in fiscal 2014.

PUBLIC ACT 98-1052 – EFFECTIVE: AUGUST 26, 2014

Amends 901(b) to add language at the bottom requiring the Comptroller to make the transfers required by that subsection within 60 days after receiving certification from the Treasurer.

PUBLIC ACT 98-674 – EFFECTIVE: JUNE 30, 2014

Amends Section 901(c)(1) to provide a 10% rate for contributions to the refund fund in fiscal 2015 and amends Section 901(c)(2) to provide a 14% rate for contributions to the replacement tax refund fund in fiscal 2015.

PUBLIC ACT 98-1098 – EFFECTIVE: AUGUST 26, 2014

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Adds new subsection (h) to provide for deposits into the Tax Compliance and Administration Fund based on collections attributable to audit activity, and amends subsection (a) to cross-reference this provision.

PUBLIC ACT 100-22 – EFFECTIVE: JULY 6, 2017

Amends Section 901(b) to reflect the change in tax rates.

PUBLIC ACT 100-23 – EFFECTIVE: JULY 6, 2017

Amends Section 901(b) to require immediate transfer of funds to the Local Government Distributive Fund after the effective date of the Act, and reduces deposits under Section 901 by 10% for fiscal year 2018.

Amends Section 901(c)(1) to provide a 9.8% rate for contributions to the refund fund in fiscal 2018 and amends Section 901(c)(2) to provide a 17.5% rate for contributions to the replacement tax refund fund in fiscal 2018.

PUBLIC ACT 100-587 – EFFECTIVE JUNE 4, 2018

Amends Section 901(b) to reduce contributions to the Local Government Distributive Fund by 5% for fiscal 2019. Amends Section 901(c)(1) to provide a 9.7% rate for contributions to the refund fund in fiscal 2019 and amends Section 901(c)(2) to provide a 15.5% rate for contributions to the replacement tax refund fund in fiscal 2019.

Corrected references to the Civil Administrative Code and to public acts that amended this section.

PUBLIC ACT 100-621 – EFFECTIVE: JULY 20, 2018

Amended subsection (d)(1) to delete the reference to repealed Section 208.1.

PUBLIC ACT 100-863 – EFFECTIVE: AUGUST 14, 2018

Made the same corrections to references to the Civil Administrative Code and to public acts that amended this section as made in Public Acts 100-587 and 100-1171.

PUBLIC ACT 100-1171 – EFFECTIVE: JANUARY 4, 2019

Made the same corrections to references to the Civil Administrative Code and to public acts that amended this section as made in Public Acts 100-587 and 100-863 and amended subsections (f) and (g) to delete the reference to funds received “during the previous month” from the provisions requiring immediate deposit of receipts.

PUBLIC ACT 101-10– EFFECTIVE: JUNE 5, 2019

Added 2020 LGDF and refund fund provisions to (b) and (c) and deleted many prior years’ provisions.

SECTION 902--NOTICE AND DEMAND

SECTION 902(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

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The Department will issue a notice for any deemed assessed liability stating the amount unpaid and demanding payment. Upon receipt of such notice the amount in the notice is required to be paid at the place and time stated.

AMENDED BY:

PUBLIC ACT 78-796 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 30, 1973

Added last sentence describing the proper procedures for delivery of the notice.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Added statement, "In the case of tax deemed assessed with the filing of a return, the Director shall give notice no later than 3 years after the date the return was filed." Also changed the term "notice" to "notice and demand".

SECTION 902(b)--JUDICIAL REVIEW

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

In the case of a deficiency deemed assessed under Section 903(a)(2) after the filing of a protest, notice and demand shall not be made until all court proceedings have terminated or the time for such proceedings has terminated.

AMENDED BY:

No amendments.

SECTION 902(c)--ACTION FOR RECOVERY OF TAXES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

At any time that the Department may commence proceedings under Section 1109, it may bring an action in court to recover any amounts due and unpaid under this Act. The certificate showing the amount of the deficiency is considered to be prima facie evidence of correctness in these matters.

AMENDED BY:

PUBLIC ACT 83-1415 - EFFECTIVE: SEPTEMBER 13, 1984

Added the statement, "...regardless of whether a notice of lien was filed under the provisions of Section 1103..."

SECTION 902(d)--SALES OR TRANSFERS

CREATED BY:

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PUBLIC ACT 83-1416 - EFFECTIVE: SEPTEMBER 13, 1984

Added this subsection which deals with sales or transfers outside the usual course of business. Provides the requirements for notification of the sale of transfer to the Department and the liability incurred by the seller/transferor and the purchaser/transferee.

AMENDED BY:

PUBLIC ACT 85-299 - EFFECTIVE: SEPTEMBER 9, 1987

Provides that the purchaser/transferee will be personally liable for the amount "owed" by the seller/transferor rather than the amount "assessed". Also provides a definition of the "amount owed and due from the seller or transferor."

PUBLIC ACT 86-923 - EFFECTIVE: JULY 1, 1989

The notice of sale or purchase of business assets should be filed with the Chicago office of the Department. Also amended the procedures taken by the Department once notification is received. The definition of the "amount owed and due from the seller or transferor" was deleted.

PUBLIC ACT 86-953 - EFFECTIVE: NOVEMBER 30, 1989

The requirement to file a notice of sale or purchase of business assets was amended to require a notice of sale or transfer of business assets. The period for notifying the Department of a sale or transfer in order for the Department to determine if any tax, penalty or interest was due was decreased from 30 days to 10 days prior to the date of sale or transfer. Finally, the purchaser or transferee should withhold the amount directed to be withheld against the purchase price until the Department provides a certificate showing that no UNPAID tax; penalty or interest is due. This certification previously showed that no tax, penalty or interest was ASSESSED AND UNPAID.

PUBLIC ACT 94-776 - EFFECTIVE: MAY 19, 2006

Changed the due date of bulk sales reports from 10 days after the transfer to 10 business days and changed the deadline for Department response from 60 days to 60 business days.

SECTION 903--ASSESSMENT

SECTION 903(a)(1)--IN GENERAL--RETURNS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The amount of tax shown to be due on the return as filed (including amended returns showing an increase in tax) is deemed assessed on the date of filing. If the tax is increased due to a mathematical error, the Department shall notify the taxpayer of the additional amount that has been assessed. This notice is not a Notice of Deficiency and cannot be protested. If a return is filed without the tax computed, the amount computed by the Department is deemed assessed on the date when payment is due.

AMENDED BY:

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PUBLIC ACT 84-127 - EFFECTIVE: AUGUST 1, 1985

Added the statement, "Such notice of additional tax due shall be issued no later than 3 years after the date the return was filed" regarding issuance of a notice on a deemed assessed liability.

SECTION 903(a)(2)--IN GENERAL--NOTICE OF DEFICIENCY

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If a Notice of Deficiency has been issued, the amount of the deficiency will be deemed assessed on the date provided by Section 904(d) if no protest is filed. If a protest is filed, the amount becomes deemed assessed upon the date of the final determination by the Department.

AMENDED BY:

No amendments.

SECTION 903(a)(3)--IN GENERAL--FEDERAL CHANGE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If an amended return is filed pursuant to Section 506(b) conceding the accuracy of the federal change, any deficiency in tax is considered deemed assessed upon the filing of the amended return.

AMENDED BY:

PUBLIC ACT 81-1405 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1980

Deleted the statement, "...concedes the accuracy of the federal change or correction..."

SECTION 903(a)(4)--IN GENERAL--PAYMENTS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any amount paid, as tax (other than amounts withheld under Article 7 or paid as estimated payments under Article 8) is considered deemed assessed upon receipt of the payment.

AMENDED BY:

No amendments.

SECTION 903(b)--LIMITATIONS ON ASSESSMENT

CREATED BY:

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PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

No deficiency shall be assessed for a year for which a return is filed unless the Notice of Deficiency was issued not later than the date prescribed in Section 905.

AMENDED BY:

No amendments.

SECTION 904--DEFICIENCIES AND OVERPAYMENTS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

As soon as practical after a return has been filed, the Department shall examine it to determine the correct amount of tax. If it is determined that more tax is due, the Department shall issue a Notice of Deficiency. If less tax is due, the Department will credit or refund the overpayment in accordance with Section 909. If no return is filed, the Department will determine the correct liability using the best information available and will issue a Notice of Deficiency for any tax, penalties and interest due.

The Notice of Deficiency will reflect the adjustments causing the liability. If a joint return is filed, the Department will issue a joint Notice of Deficiency.

If no protest is received within 45 days of the issuance of the Notice of Deficiency, the amount of the Notice will be considered deemed assessed.

AMENDED BY:

PUBLIC ACT 87-192 - EFFECTIVE: JANUARY 1, 1992

Increased the protest period for a Notice of Deficiency from 45 days to 60 days.

PUBLIC ACT 87-205, WHICH HAS AN EARLIER EFFECTIVE DATE, MADE THIS SAME CHANGE. SEE BELOW.

PUBLIC ACT 87-205 - EFFECTIVE: SEPTEMBER 3, 1991

Increased the protest period for a Notice of Deficiency from 45 days to 60 days.

SECTION 905--LIMITATIONS ON NOTICES OF DEFICIENCY

SECTION 905(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

A Notice of Deficiency will be issued not more than 3 years after a return is filed.

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AMENDED BY:

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Added a provision in subsection (a)(1) that a Notice of Deficiency will not be issued 3 years after the supplemental return was filed.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Deleted provisions relating to supplemental returns.

SECTION 905(b)--OMISSION OF 25% OF INCOME

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If the taxpayer omits in excess of 25% of base income on the return as filed, a Notice of Deficiency may be issued no later than 6 years after the return was filed.

AMENDED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Redesignated existing subsection (b) as (b)(1). Added subsection (b)(2) to create a 6-year statute of limitations for issuing a Notice of Deficiency for a deficiency arising from an undisclosed tax shelter participation that was required to be disclosed under IITA Section 501(b).

PUBLIC ACT 98-496 - EFFECTIVE: AUGUST 16, 2013

Added (b)(3) to create a 6-year statute of limitations for issuing a Notice of Deficiency in the case of a substantial understatement of withholding.

SECTION 905(c)--NO RETURN OR FRAUDULENT RETURN

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If no return was filed or a fraudulent return was filed, a Notice of Deficiency may be issued at any time.

AMENDED BY:

PUBLIC ACT 83-14 - EFFECTIVE: JULY 1, 1983

Added a provision that a Notice of Deficiency can be issued at any time if a supplemental return was not filed.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Deleted provisions relating to supplemental returns.

PUBLIC ACT 98-496 - EFFECTIVE: AUGUST 16, 2013

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Added a provision stating that a member of a unitary business group that fails to file a separate return or join in a composite return is deemed a non-filer, but the deficiency that may be asserted is limited to the increase in tax that results from adding the member to the combined group.

SECTION 905(d)--FAILURE TO REPORT A FEDERAL CHANGE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If a taxpayer fails to properly notify the Department of a federal change, a Notice of Deficiency can be issued at any time.

AMENDED BY:

PUBLIC ACT 82-661 - EFFECTIVE: SEPTEMBER 25, 1981

Added a provision for failure to notify the Department where notification is required per Section 304(c).

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Added provisions for failure to report state changes.

PUBLIC ACT 86-905 - EFFECTIVE: SEPTEMBER 11, 1989

Deleted provisions relating to failure to report other state changes.

PUBLIC ACT 91-541 - EFFECTIVE: AUGUST 13, 1999

This section was amended to provide that on or after the effective date of Public Act 91-541 (August 13, 1999) a Notice of Deficiency may be issued at any time for the taxable year for which the notification is required 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 required; provided, however, that the amount of any proposed assessment set forth in the notice shall be limited to the amount of any deficiency resulting under the Act from the recomputation of the taxpayer's net income.

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Amends the reference to the effective date of Public Act 91-541 to August 13, 1999.

SECTION 905(e)--REPORT OF FEDERAL CHANGE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If a taxpayer properly notifies the Department of a federal change, a Notice of Deficiency for any additional tax determined to be due may be issued at any time within 2 years from the date the notification was given. Any additional tax determined to be due can only be from a recomputation of the tax relating to the change.

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AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Added provisions for issuing a Notice of Deficiency when other state changes have been properly reported.

PUBLIC ACT 86-905 - EFFECTIVE: SEPTEMBER 11, 1989

Deleted provisions for issuing a Notice of Deficiency when other state changes have been properly reported.

PUBLIC ACT 90-491 - EFFECTIVE: FOR FEDERAL AUDITS FINALIZED ON OR AFTER JANUARY 1, 1998

Amends the reporting of changes affecting federal income tax section to include any changes to a federal tax credit. Also expands the provision to state any federal changes that affect net income, net loss or any Article 2 credit.

PUBLIC ACT 91-541 - EFFECTIVE: AUGUST 13, 1999

This section was amended to provide that on or after the effective date of Public Act 91-541 (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 the recomputation of the taxpayer's net income.

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Changes the wording "the effective date of this amendatory Act of the 91st General Assembly" to "August 13, 1999".

SECTION 905(f)--EXTENSION BY AGREEMENT

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The time period for issuing a Notice of Deficiency can be extended if the extension is agreed to be the taxpayer and the Department (in writing) prior to the expiration of the original statute.

AMENDED BY:

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Provides that on or after January 1, 2003, that a taxpayer who is a partnership, Subchapter S Corporation, or trust who enters into an agreement with the Department, that a notice of deficiency may be issued to the partners, shareholders, or beneficiaries of the taxpayer for flow-through items at any time prior to the expiration of the period agreed upon.

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SECTION 905(g)--ERRONEOUS REFUNDS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

In the case of an erroneous refund, a Notice of Deficiency may be issued at any time within 2 years from the date the refund was issued (5 years if fraud was involved).

AMENDED BY:

PUBLIC ACT 88-195 - EFFECTIVE: JULY 1, 1993

In cases where tax has been refunded due to an Illinois net loss carryback, and it is later determined that the amount of loss originally carried back was in error, a notice of deficiency for the erroneous refund may be issued at any time during the same time period in which a notice of deficiency can be issued on the loss year being carried back.

SECTION 905(h)--TIME RETURN DEEMED FILED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

A return filed before the last day prescribed for filing (including extensions) is considered to be filed on the last day.

AMENDED BY:

No amendments.

SECTION 905(i)--REQUEST FOR PROMPT DETERMINATION

CREATED BY:

PUBLIC ACT 76-2408 - EFFECTIVE: JUNE 29, 1970

This section contains the provisions for a taxpayer to request a prompt determination of liability for tax imposed by the IITA.

AMENDED BY:

No amendments.

SECTION 905(j)--WITHHOLDING TAX

CREATED BY:

PUBLIC ACT 78-796 - EFFECTIVE: FOR TAX YEARS ENDING AFTER DECEMBER 30, 1973

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In the case of withholding returns, a Notice of Deficiency can be issued not later than 3 years after the 15th day of the 4th month following the close of the calendar year for which the tax was withheld.

AMENDED BY:

No amendments.

SECTION 905(k)--INFORMATION REPORT PENALTIES

CREATED BY:

PUBLIC ACT 81-221 - EFFECTIVE: JANUARY 1, 1980

A Notice of Deficiency for the penalties provided by Section 1405.1(c) of the IITA may not be issued later than 3 years after the due date of the reports with respect to which the penalties are being asserted.

AMENDED BY:

No amendments.

SECTION 905(l)--WITHHOLDING RETURNS-NONFILING PENALTY

CREATED BY:

PUBLIC ACT 82-609 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1982

Deals with the penalty for filing withholding returns. A Notice of Deficiency for the Section 1004 penalties may not be issued more than 3 years after the 15th day of the 4th month following the end of the calendar year for which the withholding occurred.

AMENDED BY:

No amendments.

SECTION 905(m)--TRANSFEREE LIABILITY

CREATED BY:

PUBLIC ACT 81-1405 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1980

This section contains the time periods for issuing a Notice of Deficiency to a transferee relative to a liability asserted under Section 1405.

AMENDED BY:

PUBLIC ACT 83-346 - EFFECTIVE: SEPTEMBER 14, 1983

Amended subsection (m)(2) to refer to the return of "the certified copy of the judgment in the court proceeding" rather than to the return of "the execution of the court proceeding."

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PUBLIC ACT 84-127 - EFFECTIVE: AUGUST 1, 1985

Extended the time for issuing the Notice of Deficiency in transferee situations from one year to 2 years after expiration of the statute of limitations against the transferor. Also provided an exception to the issuance limitation in the case of an initial transferor.

SECTION 905(n)--NOTICE OF DECREASE IN NET LOSS

CREATED BY:

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Provides that on and after the effective date of this amendatory Act of the 92nd General Assembly, no notice of deficiency shall be issued as the result of a decrease determined by the Department in the net loss incurred by a taxpayer under Section 207 unless the Department has notified the taxpayer of the proposed decrease within 3 years after the return reporting the loss was filed or within one year after an amended return reporting an increase in the loss was filed, provided that in the case of an amended return, a decrease proposed by the Department more than 3 years after the original return was filed may not exceed the increase claimed by the taxpayer on the original return.

AMENDED BY:

PUBLIC ACT 94-836 - EFFECTIVE: JUNE 6, 2006

Provided that this subsection is not effective for loss years ending on or after December 31, 2002.

SECTION 906--FURTHER NOTICES RESTRICTED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Once a decision has become final on a Notice of Deficiency, the Department is barred from issuing any additional notice except in the case of fraud, mathematical error, or as provided in Section 905(d), (e) or (g).

AMENDED BY:

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

Allows additional notices of deficiency to be issued if the original notice is issued due to a return being deemed unprocessable.

SECTION 907--WAIVER OF RESTRICTIONS ON ASSESSMENT

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The taxpayer may at any time waive the restrictions on assessment and collection of a proposed liability by executing the proper notice.

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AMENDED BY:

No amendments.

SECTION 908--PROCEDURE ON PROTEST

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the procedures for protesting a proposed assessment. Also discusses when a decision of the Department becomes final and the taxpayer's right for requesting a rehearing or Department review.

AMENDED BY:

PUBLIC ACT 87-192 - EFFECTIVE: JANUARY 1, 1992

Increased the protest period for a Notice of Deficiency from 45 days to 60 days.

PUBLIC ACT 87-205, WHICH HAS AN EARLIER EFFECTIVE DATE, MADE THIS SAME CHANGE. SEE BELOW.

PUBLIC ACT 87-205 - EFFECTIVE: SEPTEMBER 3, 1991

Increased the protest period for a Notice of Deficiency from 45 days to 60 days.

PUBLIC ACT 97-1129- EFFECTIVE: AUGUST 28, 2012

Added provisions for the Tax Tribunal.

SECTION 909--CREDITS AND REFUNDS

SECTION 909(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The Department may (within the applicable period of limitations) credit any overpayment against any liability of tax imposed by the IITA of the person involved.

AMENDED BY:

PUBLIC ACT 83-1416 - EFFECTIVE: SEPTEMBER 13, 1984

Deleted "within the applicable period of limitations". Also added the provision that the Department may offset overpayments and liabilities "regardless of whether other collection remedies are closed to the Department."

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PUBLIC ACT 97-0507-EFFECTIVE: AUGUST 23, 2011

Restored language regarding the limitations period for allowing refunds or credits.

PUBLIC ACT 98-925 – EFFECTIVE: AUGUST 15, 2014

Amends Section 909(a) add a reference to the new provision in Section 909(b) allowing taxpayers to elect to have reported overpayments applied against estimated taxes on late and amended returns.

SECTION 909(b)--CREDITS AGAINST ESTIMATED TAX

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The Department is authorized to allow a taxpayer to credit an overpayment from one year to the estimated payments of the succeeding year.

AMENDED BY:

PUBLIC ACT 79-1042 - EFFECTIVE: SEPTEMBER 18, 1975

Amended section to state that the Department "may" allow a credit of an overpayment rather than "is authorized to."

PUBLIC ACT 98-925 – EFFECTIVE: AUGUST 15, 2014

Amends Section 909(b) to require the Department to adopt regulations allowing taxpayers to elect to have reported overpayments applied against estimated taxes on late and amended returns.

SECTION 909(c)--INTEREST ON OVERPAYMENT

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The Department will pay interest on overpayments at a rate of 6% per annum unless the refund is issued within 3 months of the date the return was filed or the last date prescribed for filing of the return, whichever is later. No tax will be considered paid before the due date of the return without regard to extensions.

AMENDED BY:

PUBLIC ACT 79-838 - EFFECTIVE: SEPTEMBER 8, 1975

Changed the interest rate on overpayments from 6% per annum to 9% per annum or at such adjusted rate as is established under the IRC Section 6621(b).

PUBLIC ACT 83-868 - EFFECTIVE: JANUARY 1, 1984

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Added the statement, "...as determined without regard to processing by the Comptroller..." to the section.

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Amended the subsection to state that interest will be paid on overpayments in accordance with the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: September 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 909(d)--REFUND CLAIM

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Every claim should be submitted in writing and on the form prescribed by the Department.

AMENDED BY:

No amendments.

SECTION 909(e)--NOTICE OF DENIAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

As soon as practical after the claim is filed the Department will issue a notice of denial, abatement or credit. However, if the Department within 6 months issues no notice of denial or approval, the claim is deemed denied.

AMENDED BY:

PUBLIC ACT 79-1042 - EFFECTIVE: SEPTEMBER 18, 1975

Provides that although a claim is deemed denied after 6 months, the Department can examine the claim after the 6-month period has expired and approve it in part or in total.

PUBLIC ACT 83-818 - EFFECTIVE: FOR RETURNS/CLAIMS FILED ON OR AFTER JULY 1, 1983

Rewrote Section 909(e) to delete the 6-month deemed denial clause. The section now states that if the Department has not approved or denied the claim within 6 months the claimant may file a protest. If a protest is filed, the Department shall consider the claim and, if the taxpayer has so requested, grant the taxpayer a hearing within 6 months of the date such request is filed.

PUBLIC ACT 97-1129- EFFECTIVE: AUGUST 28, 2012

Added provisions for the Tax Tribunal.

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SECTION 909(f)--EFFECT OF DENIAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

A claim denial becomes final 45 days after its issuance (or after it has been deemed denied) except for the amounts for which a protest has been filed.

AMENDED BY:

PUBLIC ACT 83-818 - EFFECTIVE: FOR RETURNS/CLAIMS FILED ON OR AFTER JULY 1, 1983

Deleted language relating to deemed denial of claim.

PUBLIC ACT 87-879 - EFFECTIVE: JANUARY 1, 1993

Increased the time period for filing a protest in response to a claim denial from 45 days to 60 days.

PUBLIC ACT 97-1129- EFFECTIVE: AUGUST 28, 2012

Added provisions for the Tax Tribunal.

PUBLIC ACT 98-463 - EFFECTIVE: AUGUST 16, 2013

Added “Independent” to the reference to the Tax Tribunal.

SECTION 909(g)--UNSIGNED RETURNS WITH OVERPAYMENTS

CREATED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

If a return reporting an overpayment is filed without a signature and the taxpayer has failed to provide a signature within 3 years after the date the return was filed, and the Department has issued a notice and demand for signature, any overpayment reported on the return is forfeited.

PUBLIC ACT 87-879 - EFFECTIVE: JANUARY 1, 1993

If an overpayment of tax is refunded based on an electronically filed return and, within 6 months after proper notification by the Department, the required signature document is not provided, the refund will be considered erroneous.

AMENDED BY:

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

Eliminates the 6-month waiting period for providing a signature before a refund can be considered erroneous.

SECTION 910--CLAIM DENIAL PROCEDURES

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CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the protest procedures for a claim denial, hearing requests and finality of decisions of the Department.

AMENDED BY:

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

Provides for a 60-day protest period for claim denials.

PUBLIC ACT 91-1129- EFFECTIVE: AUGUST 28, 2012

Added provisions for the Tax Tribunal.

SECTION 911--LIMITATIONS ON CLAIMS FOR REFUND

SECTION 911(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

A claim may be filed not later than 3 years after the date the corresponding return was filed or 1 year after the tax was paid, whichever is later.

AMENDED BY:

PUBLIC ACT 78-796 - EFFECTIVE: FOR TAX YEARS ENDING AFTER DECEMBER 30, 1973

Added statute for withholding claims. These claims must be filed within 3 years of the 15th day of the 4th month following the close of the calendar year for which the withholding occurred.

SECTION 911(b)--FEDERAL CHANGES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

A Federal change, which creates an overpayment of Illinois tax, must be filed within 2 years of the date on which notification of the change was due. The claim is limited to the amount created due to the Federal change.

AMENDED BY:

PUBLIC ACT 78-268 - EFFECTIVE: AUGUST 1, 1969

Added section regarding an overpayment created by a tentative carryback adjustment paid before January 1, 1974.

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PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Added a provision that claims involving other state changes which create an overpayment of Illinois liability must be filed within 2 years of the date which notification of the change was required.

PUBLIC ACT 86-905 - EFFECTIVE: SEPTEMBER 11, 1989

Deleted provision relating to claims for "other state" changes.

PUBLIC ACT 90-491 - EFFECTIVE: FOR FEDERAL AUDITS FINALIZED ON OR AFTER JANUARY 1, 1998

Amends the refunds based on changes affecting federal income tax section to include any changes to a federal tax credit. Also expands the provision to state any federal changes that affect net income, net loss or any Article 2 credit.

SECTION 911(c)--EXTENSION BY AGREEMENT

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The Department and the taxpayer can agree in writing to extend the period for filing a claim before the original period has expired.

AMENDED BY:

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Provides that on or after January 1, 2003, that anytime a partnership, Subchapter S corporation, or trust enters into an extension by agreement with the Department, that a claim for refund may be issued to the partners, shareholders, or beneficiaries of the taxpayer for flow-through items at any time prior to the expiration of the period agreed upon.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Amended to refer to refund claims “filed by” rather than “issued to” partners.

SECTION 911(d)--LIMIT ON AMOUNT OF CLAIM/REFUND

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

A claim filed within the 3-year period cannot exceed the amount of tax paid within the 3-year period immediately preceding the filing of the claim. If the claim is not filed within the 3-year period, the amount of the claim cannot exceed the amount of tax paid within the 1-year period immediately preceding the filing of the claim.

AMENDED BY:

No amendments.

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SECTION 911(e)--TIME RETURN DEEMED FILED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

For purposes of Section 909, a return filed before or after the last day prescribed for filing the return (without regard to extensions) is considered to be filed on that last day.

AMENDED BY:

PUBLIC ACT 79-580 - EFFECTIVE: AUGUST 26, 1975

Amended subsection to provide that for purposes of Section 909, a return filed before the last day prescribed for filing the return (including extensions) is considered to be filed on that last day.

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Amended this subsection to change the cross-reference to Section 701 to refer to all withholding under Article 7.

SECTION 911(f)--CLAIM BASED ON ESTIMATED/TENTATIVE PAYMENTS

CREATED BY:

PUBLIC ACT 81-1405 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1980

No claim may be filed based on the taxpayer's taking a credit for estimated tax payments may be filed more than 3 years after the due date of the return (as prescribed by Section 505) which was required to be filed for the year for which the estimated payments were made.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Extended above statute to include tentative payments and tax withheld.

PUBLIC ACT 95-0233 – EFFECTIVE AUGUST 16, 2007

Extended above statute to include pass-through withholding.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Corrected the subsection to apply to credits as well as refunds and to apply when no return was filed within 3 years of the extended due date, rather than when no refund claim was filed.

SECTION 911(g)--LIMITATION FOR NET LOSS CARRYBACKS

CREATED BY:

PUBLIC ACT 84-1042 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

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If a claim relates to a carryback of an Illinois net loss, the claim may be filed within a period which ends 3 years after the last day prescribed for filing the return (including extensions) for the net loss year or any extension period of the loss year, whichever expires later. In this instance the limitations of subsection (d) do not apply.

AMENDED BY:

PUBLIC ACT 91-541 - EFFECTIVE: AUGUST 13, 1999

This section was amended to provide that if a claim for refund relates to an overpayment attributable to the carryover of an Article 2 credit or a Section 207 loss earned, incurred or used in a federal change year, the claim may be filed within the period prescribed by Section 911(b) for federal change refund claims.

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Changes the wording from the “effective date” to August 13, 1999”.

SECTION 911(h)--CLAIM FOR REFUND BASED ON NET LOSS

CREATED BY:

PUBLIC ACT 92-846 - EFFECTIVE: AUGUST 23, 2002

Provides that for on and after the effective date of this amendatory Act (August 23, 2002), that no claim for refund based on a net loss shall be allowed if it was not reported to the Department within 3 years of the due date of the loss year return (including extensions). This applies to original returns and amended returns.

AMENDED BY:

PUBLIC ACT 94-836 - EFFECTIVE: JUNE 6, 2006

Provided that this subsection is not effective for loss years ending on or after December 31, 2002, except that no refund resulting from a net loss carryover may be claimed unless the loss year return was filed within 3 years of the extended due date.

SECTION 911(i) –TOLLING OF LIMITATIONS FOR DISABLED INDIVIDUALS

CREATED BY:

PUBLIC ACT 98-0970 – EFFECTIVE: AUGUST 15, 2014

Added this subsection to toll the statute of limitations for periods during which the taxpayer is disabled and unable to manage his or her financial affairs. This provision adopts the language of IRC Section 6511(h).

SECTION 911.1--JOINT TAXPAYER REFUND

CREATED BY:

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PUBLIC ACT 85-473 - EFFECTIVE: JANUARY 1, 1988

If the Department withholds any refund due on a joint return because of any other liability to the State, the taxpayer that jointly filed the return and is not liable to the state shall be entitled to the portion of the joint refund attributable to himself or herself.

AMENDED BY:

PUBLIC ACT 96-520 - EFFECTIVE: AUGUST 14, 2009

This section applies only to tax years ending prior to December 31, 2009.

SECTION 911.2--REFUNDS WITHHELD, TAX CLAIMS OF OTHER STATES

CREATED BY:

PUBLIC ACT 92-492 - EFFECTIVE: JANUARY 1, 2002

Provides that a unit or official of a claimant state, or the duly authorized agent of that unit or official, charged with the imposition, assessment, or collection of State income taxes (tax officer) may certify to the Director of Revenue, the existence of a taxpayer's delinquent income tax liability and request the Director to withhold any refund to which the taxpayer is entitled, but only if the laws of the claimant state allow the Director to certify an income tax liability, allow the Director to request the tax officer to withhold the taxpayer's tax refund, and provide for the payment of the refund to the State of Illinois.

AMENDED BY:

PUBLIC ACT 92-826 - EFFECTIVE: AUGUST 21, 2002

Creates Section 911.2(e)(3.5) by providing that when another state has requested that the department withhold a refund for taxes owed to that state, the Director is to inform the taxpayer that the refund has been withheld and that the tax liability has been paid to the claimant state.

PUBLIC ACT 96-0520 – EFFECTIVE AUGUST 14, 2009

Provides that the "injured spouse" provisions in subsection (h) apply only to tax years ending prior to December 31, 2009.

SECTION 911.3--REFUNDS WITHHELD; ORDER OF HONORING REQUESTS

CREATED BY:

PUBLIC ACT 92-826 - EFFECTIVE: AUGUST 21, 2002

Creates Section 911.3 which sets the order of priority the Department must follow when considering requests to withhold refunds to pay delinquent taxes.

AMENDED BY:

PUBLIC ACT 93-836 - EFFECTIVE: JULY 29, 2004

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Added subsection (6) allowing overpayments to be offset against circuit court fees.

PUBLIC ACT 97-0269- EFFECTIVE: AUGUST 8, 2011

Added subsection (4.5) allowing overpayments to be offset against non-tax federal obligations.

SECTION 912--RECOVERY OF ERRONEOUS REFUND

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

An erroneous refund is considered a deficiency on the date made.

AMENDED BY:

No amendments.

SECTION 913--ACCESS TO BOOKS AND RECORDS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any authorized officer or employee of the Department may examine books, records and other papers and documents during the business hours of the day.

AMENDED BY:

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

Allows the Department to issue a 60-day demand letter for information. Failure to produce the information requested within 60 days of the letter prohibits the taxpayer from producing the information at a later date.

PUBLIC ACT 89-711 - EFFECTIVE: FEBRUARY 14, 1997

Eliminates the 60-day letter provisions.

SECTION 914--CONDUCT OF INVESTIGATIONS/HEARINGS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Procedures covering the Department's authority to conduct investigations and hearing and examine books, records, etc. or obtain testimony from officers, employees, etc. of the taxpayer.

AMENDED BY:

PUBLIC ACT 85-299 - EFFECTIVE: SEPTEMBER 9, 1987

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Provides that certified reproduced copies and certified computer printouts of Department records may be used as evidence in investigations and hearings.

PUBLIC ACT 97-1129- EFFECTIVE: AUGUST 28, 2012

Added provisions for the Tax Tribunal.

SECTION 915--IMMUNITY OF WITNESSES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

No person can refuse to testify in a Department matter on the grounds that it might incriminate him or her criminally. At the same time, no criminal action will be brought forth by the testimony of a person under subpoena by the Department.

AMENDED BY:

No amendments.

SECTION 916--PRODUCTION OF WITNESSES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the Department's authority to issue subpoenas and subpoenas duces tecum. It also covers fees for witnesses and judicial enforcement of attendance by witnesses.

AMENDED BY:

PUBLIC ACT 83-334 - EFFECTIVE: SEPTEMBER 14, 1983

Deleted the phrase "or any judge thereof" (of the Circuit Court) from section.

PUBLIC ACT 97-1129- EFFECTIVE: AUGUST 28, 2012

Added provisions for the Tax Tribunal.

SECTION 917--CONFIDENTIALITY/INFORMATION SHARING

SECTION 917(a)--CONFIDENTIALITY

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

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All information received by the Department is confidential. Any person who divulges confidential information may be guilty of a misdemeanor and subject to fine or imprisonment.

AMENDED BY:

PUBLIC ACT 76-2515 - EFFECTIVE: JULY 2, 1970

Increased fines and imprisonment penalties

PUBLIC ACT 77-485 - EFFECTIVE: JULY 27, 1971

Changed place of imprisonment from the county jail to a penal institution other than a penitentiary.

PUBLIC ACT 77-1005 - EFFECTIVE: AUGUST 17, 1971

Substituted "person" for officer or employee of such Department." Again deleted "in the county jail" and rephrased provision for fine and imprisonment.

PUBLIC ACT 77-2222 - EFFECTIVE: JANUARY 1, 1973

Substituted " Class A misdemeanor" for language regarding fine and imprisonment.

PUBLIC ACT 82-1033 - EFFECTIVE: DECEMBER 22, 1982

Added provision that this section is not applicable to information furnished to a licensed attorney representing the taxpayer.

PUBLIC ACT 84-142 - EFFECTIVE: JANUARY 1, 1986

Added exception for releasing information to the Illinois Scholarship Commission.

PUBLIC ACT 93-835 - EFFECTIVE: JULY 29, 2004

Added exception for releasing information to Public Aid, State's Attorneys and the Attorney General for collection of child support.

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Changed reference from Public Aid to Healthcare and Family Services.

PUBLIC ACT 99-0571 – EFFECTIVE JULY 15, 2016

Allows information sharing with the Treasurer and IDES for administration of the Illinois Secure Choice Savings Program.

SECTION 917(b)--PUBLIC INFORMATION

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The Director can publish or make available the names and addresses of persons filing returns under the IITA or make statistics available where the information is grouped into aggregates.

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AMENDED BY:

No amendments.

SECTION 917(c)--GOVERNMENTAL AGENCIES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The Director can provide information to the federal government or any other state if they agree to provide the Department with similar information.

AMENDED BY:

PUBLIC ACT 83-95 - EFFECTIVE: JANUARY 1, 1984

The Department may exchange information with the Illinois Department of Public Aid in order to verify income.

PUBLIC ACT 83-1415 - EFFECTIVE: SEPTEMBER 13, 1984

The Department may exchange information with the principal officer of any Department of the State of Illinois, which licenses persons to engage in any occupation.

PUBLIC ACT 84-1405 - EFFECTIVE: SEPTEMBER 18, 1986

Authorizes the Director to exchange information with the Director of Employment Security.

PUBLIC ACT 85-299 - EFFECTIVE: SEPTEMBER 9, 1987

Permits the Director to inform the Secretary of State that a corporation which has been issued a certificate of incorporation has not filed a return or paid the tax, penalty or interest shown on the return or has not paid a final assessment of tax, penalty or interest due.

PUBLIC ACT 85-982 - EFFECTIVE: DECEMBER 16, 1987

Allows the Director to make available to the Director or principal officer of any other state agency, information that a person employed by such Department has failed to file a requisite return or pay requisite tax, penalty or interest.

PUBLIC ACT 89-507 - EFFECTIVE: IMMEDIATELY

Adds the Department of Human Services to the list of agencies that the Department can provide with certain information.

PUBLIC ACT 93-25 - EFFECTIVE: JUNE 20, 2003

Allows the Department to share information with other state agencies for purposes of verifying that the taxpayer is qualified to be a vendor of goods and services to the agencies.

PUBLIC ACT 93-841 - EFFECTIVE: JULY 30, 2004

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Added exception for releasing information to the Department of Aging to verify qualification for circuit breaker and pharmaceutical assistance.

PUBLIC ACT 95-0331 – EFFECTIVE AUGUST 21, 2007

Changed reference from Public Aid to Healthcare and Family Services.

PUBLIC ACT 99-0143 - EFFECTIVE: JULY 27, 2015

Amended wording to change references to "disabled" veterans to "veterans with disabilities".

PUBLIC ACT 100-47 – EFFECTIVE AUGUST 11, 2017

Added the provision allowing the Department to share information with the Treasurer's Office for purposes of administering the unclaimed property laws.

PUBLIC ACT 100-863 – EFFECTIVE: AUGUST 14, 2018

Corrected the reference to the Revised Uniform Unclaimed Property Act.

SECTION 917(d)--MULTISTATE TAX COMPACT--DELETED

CREATED BY:

PUBLIC ACT 77-485 - EFFECTIVE: JULY 27, 1971

The Director may exchange information with the Executive Director of the Multistate Tax Compact.

DELETED BY:

PUBLIC ACT 79-639 - EFFECTIVE: AUGUST 29, 1975

SECTION 917(d)--PUBLIC INSPECTION OF ADMINISTRATIVE DECISIONS

CREATED BY:

PUBLIC ACT 88-669 - EFFECTIVE: DECISIONS ISSUED ON OR AFTER JANUARY 1, 1995

Provides that the Director of the Department of Revenue will make administrative decisions public. The decisions will be available for public inspection and publication within 180 days of their issuance. Certain confidential information will be deleted from the decision before it is made public.

AMENDED BY:

No amendments.

SECTION 917(e)--CONFIDENTIALITY

CREATED BY:

PUBLIC ACT 90-491 - EFFECTIVE: January 1, 1998

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Amends the confidentiality provisions to allow the Department to provide taxpayer information to another party if the taxpayer, taxpayer's spouse (on a joint return) or authorized representative of the taxpayer so requests.

AMENDED BY:

No Amendments

SECTION 918--PLACE OF HEARINGS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any taxpayer that is a resident of Illinois or has its commercial domicile in Illinois will have any hearing held at the Department's location closest to that place of residency or commercial domicile. If the taxpayer is located in Cook County, the hearing will be held in Cook County. If the taxpayer is not a resident of the state or does not have its commercial domicile in Illinois, the hearing will be held in Cook County.

AMENDED BY:

PUBLIC ACT 97-1129- EFFECTIVE: AUGUST 28, 2012

Added provisions for the Tax Tribunal.

SECTION 1001--FAILURE TO FILE TAX RETURNS

SECTION 1001(a)--FAILURE TO FILE TAX RETURNS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any return that is not filed on or before the last day prescribed for filing (including extensions) is subject to a Section 1001 penalty of 5% for the first month late and an additional 5% for each additional month (or fraction thereof) the return is late up to a 25% penalty. The penalty is based on the tax shown on the return less any payments made on or before the date prescribed for payment of the tax.

AMENDED BY:

PUBLIC ACT 82-609 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1982

Rewrote the section and added two penalties (Sections 1001(a)(2) and (3)) for failure to pay tax due. Also added subsections (b) and (c) which related to the composition of the failure to file and failure to pay penalties and subsection (d) which contained the special rule that if the amount of tax required to be shown on the return was less than the amount shown on the return the Section 1001 penalty would be correspondingly reduced.

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PUBLIC ACT 83-1428 - EFFECTIVE: DECEMBER 1, 1984

Increased penalty rates to 7.5% per month (37.5% in aggregate) for the Section 1001(a)(1) penalty and .75% per month (37.5% in aggregate) for Sections 1001(a)(2) and (3) penalties.

PUBLIC ACT 84-127 - EFFECTIVE: AUGUST 1, 1985

Deleted the phrase "and not due to willful neglect" from the reasonable cause statement. Deleted the failure to pay penalties included in Sections 1001(a)(2) and (3) and the corresponding provisions in Sections 1001(b) and (c). Finally, deleted subsection (d) and included the special rule as the final paragraph in Section 1001.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Deleted paragraph, which stated that if the amount required to be shown on the return was less than the amount shown on the return, the Section 1001 penalty would be correspondingly reduced. (It was determined that this paragraph was unnecessary.)

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deletes all language describing the failure to file penalty. States that a penalty will be applied in accordance with the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: September 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Renumbered existing Section 1001 to be Section 1001(a).

SECTION 1001(b)--FAILURE TO DISCLOSE REPORTABLE TRANSACTIONS

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Created subsection (b) to impose a penalty for failure to disclose tax shelter participation as required by Section 501(b).

AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Makes technical changes to reflect amendments to the IRC and to change the criteria for abatement of the penalty to allow abatement only when the tax avoidance transaction is not a listed transaction and abatement would promote compliance with and sound administration of the IITA.

SECTION 1001(c)--LIMIT ON PENALTY FOR FAILURE TO DISCLOSE REPORTABLE TRANSACTIONS

CREATED BY:

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PUBLIC ACT 93-840 - EFFECTIVE: July 30, 2004

Created subsection (c) to limit the penalty in subsection (b) to 10% of the increase in net income attributable to reportable transactions.

SECTION 1002--FAILURE TO PAY TAX

SECTION 1002(a)--NEGLIGENCE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If any part of a deficiency is due to negligence or intentional disregard of the rules (but not fraud) a penalty of 5% of the deficiency is applicable.

AMENDED BY:

PUBLIC ACT 83-1428 - EFFECTIVE: DECEMBER 1, 1984

Increased penalty rate to 7.5%.

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deletes all language describing the negligence penalty. States that a penalty will be applied in accordance with the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: September 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 1002(b)--FRAUD

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If any part of a deficiency is due to fraud, a penalty of 50% of the deficiency is applicable. (Section 1002(a) and (b) are mutually exclusive.)

AMENDED BY:

PUBLIC ACT 83-1428 - EFFECTIVE: DECEMBER 1, 1984

Increased penalty rate to 75%.

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deletes all language describing the fraud penalty. States that a penalty will be applied in accordance with the Uniform Penalty and Interest Act.

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PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 1002(c)--NONWILLFUL FAILURE TO PAY WITHHOLDING TAX

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any person failing to file a withholding return or pay the tax withheld from employees shall be liable for the Section 1002(a) penalty and the penalty cannot be collected from the employees.

AMENDED BY:

PUBLIC ACT 79-6thSS-4 - EFFECTIVE: OCTOBER 1, 1976

Added subsection (c)(2), which provides for a penalty of 5% of the underpayment if a withholder fails to pay 90% of the tax due on the due date.

PUBLIC ACT 83-1428 - EFFECTIVE: DECEMBER 1, 1984

Increased penalty rate to 7.5%.

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deletes all language describing the non-willful failure to pay withholding tax penalty. States that a penalty similar to subsection (1) will be applied in accordance with the Uniform Penalty and Interest Act. Deletes the penalty contained in subsection (2).

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 1002(d)--WILLFUL FAILURE TO COLLECT AND PAY TAX

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any person who willfully fails to collect, truthfully account for and pay over the tax imposed by this Act or willfully attempts in any manner to evade or defeat the tax or the payment thereof is liable for a penalty equal to the amount of the tax evaded. (This penalty applies to withholders. If this penalty is applied, Section 1002(a) and (b) penalties should not be applied.) A definition of the term "person" for purposes of this section is also included.

AMENDED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deletes all language describing the willful failure to collect and pay over tax penalty. States that a penalty will be applied in accordance with the Uniform Penalty and Interest Act.

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PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 1002(e)--PENALTIES ASSESSABLE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The penalties provided by this Act shall be paid upon notice and demand and shall be assessed, collected and paid in the same manner as taxes.

AMENDED BY:

PUBLIC ACT 78-796 - EFFECTIVE: FOR TAX YEARS ENDING AFTER DECEMBER 31, 1973

Added subsection (e)(2) providing that any penalty assessed under Section 804 is deemed assessed unless no return is filed for the taxable year ((e)(2)(ii)) and that any penalty assessed under Section 1001 is deemed assessed except for that portion which is attributable to a deficiency (e)(2)(i).

PUBLIC ACT 82-609 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1982

Added reference to Section 1001(a)(2) and (3) penalties in subsection (e)(2)(iii). Also added subsection (e)(3), which contains the procedures for assessing the Section 1004 penalty for failure to file withholding returns or annual transmittal forms for wage and tax statements.

PUBLIC ACT 84-127 - EFFECTIVE: AUGUST 1, 1985

Deleted references to Section (a)(2) and (3) penalties. Added subsection (e)(4), which contains the procedures for assessing the Section 1005 penalty.

PUBLIC ACT 85-299 - EFFECTIVE: SEPTEMBER 9, 1987

Added subsection (e)(5), which contains the procedures for assessing the Section 1006 penalty.

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deletes subsection (2)(i) and (2)(ii) relating to the assessment of Sections 1001 and 804 penalties, which are attributable to deficiencies. Deletes subsection (4) relating to the assessment of the Section 1005 penalty. Deletes subsection (5) relating to the assessment of the Section 1006 penalty. This information is now contained in the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

PUBLIC ACT 89-379 - EFFECTIVE: JANUARY 1, 1996

Amends Section 1002(e)(3). The amendment eliminates all of the preliminary notice procedures previously contained in this Section.

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

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Created subsection (e)(4) to provide that the penalty for failure to disclose reportable transactions in Section 1005(b) is assessed when the related tax is assessed.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Added references to penalties imposed by and assessment provisions in the UPIA and corrected paragraph (4) to refer to Section 1005(a) rather than (b).

SECTION 1002(f)--DETERMINATION OF DEFICIENCY

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The amount shown, as tax on the return will only be taken into account in determining the amount of the deficiency if the return was filed on or before the last day prescribed by law for the filing of the return (including extensions).

AMENDED BY:

No amendments.

SECTION 1003--INTEREST ON DEFICIENCIES

SECTION 1003(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any tax that is not paid on or before the date prescribed for payment shall have interest applied at a rate of 6% per annum.

AMENDED BY:

PUBLIC ACT 78-796 - EFFECTIVE: FOR TAX YEARS ENDING AFTER DECEMBER 30, 1973

Provides an exception to interest if a waiver of restrictions on assessment and collection has been filed and a Notice and Demand has not been issued within 30 days. In this case, interest will not accrue from the 31st day to the date of issuance of the Notice and Demand.

PUBLIC ACT 79-838 - EFFECTIVE: SEPTEMBER 8, 1975

Changed the interest rate on deficiencies from 6% per annum to 9% per annum or at such adjusted rate as is established under the IRC Section 6621(b).

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deleted language discussing the interest rate and methods. Added reference to the Uniform Penalty and Interest Act.

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PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 1003(b)--INTEREST TREATED AS TAX

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any interest imposed will be considered deemed assessed upon the assessment of the tax or penalty to which it relates.

AMENDED BY:

No amendments.

SECTION 1003(c)--NO INTEREST ON INTEREST--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

No interest is imposed on interest.

AMENDED BY:

No amendments.

DELETED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

This information is now contained in the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 1003(c)--EXCEPTION AS TO ESTIMATED TAX

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Section 1003 does not apply to any failure to pay estimated tax.

AMENDED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

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Re-lettered this section from (g) to (c).

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 1003(d)--INTEREST ON PENALTIES--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Interest is imposed on a penalty only if the penalty is not paid within 10 days of the Notice and Demand therefore and only from the date of the Notice and Demand to the date of payment.

AMENDED BY:

No amendments.

DELETED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

This information is now contained in the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 1003(e)--PMTS W/IN 10 DAYS OF NOTICE/DEMAND--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If payment is made within 10 days of issuance of a Notice and Demand, interest does not accrue for the period after issuance of the Notice and Demand.

AMENDED BY:

No amendments.

DELETED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

This information is now contained in the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: September 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

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SECTION 1003(f)--INTEREST ON ERRONEOUS REFUND--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Interest will accrue on a deficiency due to an erroneous refund at a rate of 6% per annum.

AMENDED BY:

PUBLIC ACT 79-838 - EFFECTIVE: SEPTEMBER 8, 1975

Changed the interest rate on deficiencies from 6% per annum to 9% per annum or at such adjusted rate as is established under the IRC Section 6621(b).

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

No interest will be charged if the erroneous refund is for an amount less than $500 and is due to a mistake of the Department.

DELETED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

This information is now contained in the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 1004--FAILURE TO FILE--WITHHOLDING

CREATED BY:

PUBLIC ACT 82-609 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1982

A taxpayer failing to file a quarterly withholding return or the annual transmittal form for wage and tax statements shall incur the penalties set forth in Section 1004.

AMENDED BY:

PUBLIC ACT 83-1428 - EFFECTIVE: DECEMBER 1, 1984

Increased the Section 1004 penalty amounts by 50%.

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deleted all language relating to the description of the penalty. This information is now contained in the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: September 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

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SECTION 1005--PENALTY FOR UNDERPAYMENT OF TAX

SECTION 1005(a)--PENALTY FOR UNDERPAYMENT OF TAX

CREATED BY:

PUBLIC ACT 84-127 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER JANUARY 1, 1986

If any amount of tax required to be shown on the return is not paid on or before the date prescribed for filing the return (without regard to extensions) a penalty is imposed at a rate of 6% per annum on the underpayment unless reasonable cause applies. If the amount required to be shown, as tax on the return is less than the amount shown as tax on the return, the penalty is correspondingly decreased.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Deleted the provision that the penalty will be decreased if the tax shown on the return is decreased. (It was determined that the paragraph was unnecessary.)

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deleted all language relating to the description of the penalty. This information is now contained in the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Renumbered existing Section 1005 to be Section 1005(a).

SECTION 1005(b)--REPORTABLE TRANSACTION PENALTY

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Created subsection (b) to impose a penalty equal to 20% of any deficiency attributable to a transaction that is required to be disclosed under Treasury Regulation Section 1.6011-4.

SECTION 1005(c)--100% INTEREST PENALTY

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

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Created subsection (c) to impose a penalty equal to 100% of the interest accruing on any deficiency attributable to a tax avoidance transaction if the amount is not paid before the taxpayer is contacted by the IRS or the Department regarding the tax avoidance transaction.

SECTION 1005(d)--150% INTEREST RATE

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Created subsection (d) to increase the interest accruing on a deficiency attributable to a tax avoidance transaction at 150% of the usual rate if the notice of deficiency is issued before the taxpayer is contacted by the IRS or the Department regarding the tax avoidance transaction.

SECTION 1006--FRIVOLOUS RETURNS

CREATED BY:

PUBLIC ACT 85-299 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

A penalty of $500 is imposed upon any individual who files a frivolous return.

AMENDED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deleted all language relating to the description of the penalty. This information is now contained in the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

SECTION 1007--FAILURE TO REGISTER TAX SHELTER OR MAINTAIN LIST

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Created penalties for failure to comply with the requirements of Section 1405.5 (registration of tax shelters) or Section 1405.6 (disclosure of lists of investors in tax shelters).

AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Makes technical changes to reflect amendments to the IRC and to change the criteria for abatement of the penalty to allow abatement only when the tax avoidance transaction is not a listed transaction and abatement would promote compliance with and sound administration of the IITA.

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SECTION 1008--PROMOTING TAX SHELTERS

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Created penalties for violations of IRC Section 6700 (promotion of abusive tax shelters).

SECTION 1101--LIEN FOR TAX

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the Department's authority and procedures for filing liens. A notice of lien must be filed within 2 years of the date all proceedings have terminated for review of an assessment or if no tax was paid with a return filed with the Department within 2 years from the date the return was filed.

AMENDED BY:

PUBLIC ACT 83-581 - EFFECTIVE: SEPTEMBER 17, 1983

Changed the time for filing a notice of lien from 2 years to 3 years.

PUBLIC ACT 83-1416 - EFFECTIVE: SEPTEMBER 13, 1984

For purposes of this subsection, a tax return filed before the last day prescribed for filing (including extensions) shall be deemed to have been filed as of the last day.

PUBLIC ACT 86-905 - EFFECTIVE: SEPTEMBER 11, 1989

Rewrote subsection (a) and (b) discussing the Department's lien against the real and personal property of a person and the date on which it is in effect.

PUBLIC ACT 97-0507- EFFECTIVE: AUGUST 23, 2011

Amended subsection (d) to refer to itself rather than (c) and to suspend the period for filing a notice of lien when filing is prohibited by other law.

PUBLIC ACT 98-446 - EFFECTIVE: AUGUST 16, 2013

Amended Subsection (d) to toll the period for filing a lien while a taxpayer is in compliance with a payment plan.

SECTION 1102--JEOPARDY ASSESSMENTS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

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This section contains the Department's authority and procedures for issuance of a jeopardy assessment.

AMENDED BY:

PUBLIC ACT 83-358 - EFFECTIVE: SEPTEMBER 14, 1983

Changed reference from "Recorder of Deeds of the county" to "recorder of the county."

PUBLIC ACT 92-826 - EFFECTIVE: JANUARY 1, 2003

Amended section (a)(2) by providing that the taxpayer is liable for the filing fee incurred by the Department for filing the lien and the filing fee incurred by the Department to file the release of that lien. The filing fees shall be paid to the Department in addition to payment of the tax, penalty, and interest included in the amount of the lien.

PUBLIC ACT 100-22 – EFFECTIVE JANUARY 1, 2019

Made amendments to implement the State Tax Lien Registry.

SECTION 1103--FILING AND PRIORITY OF LIENS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the procedures for the filing of liens and the priority of the Department's liens in comparison to the liens of any other purchaser, mortgagee, judgment creditor or other lien holder.

AMENDED BY:

PUBLIC ACT 83-358 - EFFECTIVE: SEPTEMBER 14, 1983

Revised reference to Recorder of Deeds.

PUBLIC ACT 84-221 - EFFECTIVE: SEPTEMBER 1, 1985

Added subsection (d) containing provisions for the Department to pay the lien fees.

PUBLIC ACT 85-299 - EFFECTIVE: SEPTEMBER 9, 1987

Amends subsection (a) to specify that Illinois Department of Revenue liens are superior to unfiled federal tax liens.

PUBLIC ACT 86-905 - EFFECTIVE: SEPTEMBER 11, 1989

Adds that the Department's liens have preference over the rights of the holder of a security interest and mechanics lien or to the list included in the section. Deleted statement in subsection (a) that states that Revenue liens are superior to unfiled federal tax liens.

PUBLIC ACT 92-826 - EFFECTIVE: JANUARY 1, 2003

Adds subsection (e) specifying that the taxpayer is liable for the filing fee incurred by the Department for filing the lien and the filing fee incurred by the Department to file the release of that lien. The filing

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fees shall be paid to the Department in addition to payment of the tax, penalty, and interest included in the amount of the lien.

PUBLIC ACT 100-22 – EFFECTIVE JANUARY 1, 2019

Made amendments to implement the State Tax Lien Registry.

SECTION 1104--DURATION OF LIEN

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Liens continue for up to 5 years from the date of filing.

AMENDED BY:

PUBLIC ACT 83-1416 - EFFECTIVE: SEPTEMBER 13, 1984

Increased maximum length of lien to 20 years. The amendment applies to any lien, which has not expired on or before September 13, 1984.

SECTION 1105--RELEASE OF LIENS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the procedures for releasing liens and jeopardy assessments.

AMENDED BY:

PUBLIC ACT 82-265 - EFFECTIVE: JANUARY 1, 1982

Added second paragraph to subsection (d)(5), which relates to the proper notification of release of the person against whom the lien was filed.

PUBLIC ACT 83-358 - EFFECTIVE: SEPTEMBER 14, 1983

Revised references in subsection (e) from Recorder of Deeds to recorder.

PUBLIC ACT 83-1416 - EFFECTIVE: SEPTEMBER 13, 1984

Added references in subsection (d) relating to Section 1001(a)(2) and (3) penalties.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Deleted references in subsection (d) relating to Section 1001(a)(2) and (3) penalties.

PUBLIC ACT 92-826 - EFFECTIVE: JANUARY 1, 2003

Provides that the Department shall release all or any portion of property subject to any lien provided for in the Illinois Income Tax Act upon payment by the taxpayer to the Department in cash or by

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guaranteed remittance of an amount representing the filing fees and charges for the lien and the filing fees and charges for the release of a lien.

PUBLIC ACT 100-22 – EFFECTIVE JANUARY 1, 2019

Made amendments to implement the State Tax Lien Registry.

SECTION 1106--NONLIABILITY FOR COSTS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The Department is not responsible for any costs, is not required to post any bonds or make any deposits relating to any legal proceedings pursuant to the provisions of the IITA.

AMENDED BY:

PUBLIC ACT 83-358 - EFFECTIVE: SEPTEMBER 14, 1983

Revised reference to "Recorder of Deeds" to "recorder".

PUBLIC ACT 83-889 - EFFECTIVE: JANUARY 1, 1985

Deleted the statement that the Department will not pay recordation fees for filing notices or documents with the Recorder of Deeds or Registrar of Titles.

SECTION 1107--CLAIM TO PROPERTY

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the procedures when a person claims that property was wrongfully seized.

AMENDED BY:

PUBLIC ACT 82-783 - EFFECTIVE: JULY 13, 1982

Revised reference to laws of Civil Procedure.

PUBLIC ACT 83-346 - EFFECTIVE: SEPTEMBER 14, 1983

Revised terminology relating to judicial proceedings, judgments, and enforcement of judgments.

SECTION 1108--FORECLOSURE ON REAL PROPERTY

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

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This section contains the procedures for liening and foreclosing on real property. The foreclosure shall not be instituted more than 5 years after the filing of the notice of lien.

AMENDED BY:

PUBLIC ACT 79-1366 - EFFECTIVE: AUGUST 6, 1976

Substituted "in the circuit court" for "in any court of competent jurisdiction."

PUBLIC ACT 82-783 - EFFECTIVE: JULY 13, 1982

Revised reference to laws of Civil Procedure.

SECTION 1109--DEMAND AND SEIZURE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the procedures for demand and seizure of liened property. No proceedings may be commenced more than 5 years after the filing of the notice of lien.

AMENDED BY:

PUBLIC ACT 79-1366 - EFFECTIVE: AUGUST 6, 1976

Deleted "of record" from "court of record".

PUBLIC ACT 81-443 - EFFECTIVE: JANUARY 1, 1980

Changed the language concerning the levying of taxpayers' property.

PUBLIC ACT 83-1415 - EFFECTIVE: SEPTEMBER 13, 1984

Changed period of time for levying property from 5 years to 20 years from the date the notice of lien was filed.

PUBLIC ACT 84-1455 - EFFECTIVE: JANUARY 6, 1987

Allowed the Illinois Department of Revenue to sell property seized by the Illinois State Police.

PUBLIC ACT 85-299 - EFFECTIVE: SEPTEMBER 9, 1987

Designated Department personnel may levy specified property by serving notice of levy on the person making such payment. Also adds language concerning levies on compensation.

PUBLIC ACT 86-905 - EFFECTIVE: SEPTEMBER 11, 1989

Amended section to state that no proceedings for a levy shall be commenced more than 20 years after the latest date for filing the notice of lien (rather than the actual date the notice was filed), WITHOUT REGARD TO WHETHER SUCH NOTICE WAS ACTUALLY FILED.

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

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Allows the Department to levy the wages of federal employees.

SECTION 1110--REDEMPTION BY STATE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The provisions of Sections 5(g) and (h) of the ROT Act (relating to the time for redemption by Illinois of real estate sold at a judicial or execution sale) apply to the IITA.

AMENDED BY:

No amendments.

SECTION 1201--ADMINISTRATIVE REVIEW LAW

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The provisions of the Administrative Review Act shall apply to all judicial proceedings of final actions by the Department.

AMENDED BY:

PUBLIC ACT 78-796 - EFFECTIVE: FOR TAX YEARS ENDING AFTER DECEMBER 30, 1973

Changed the word "institute" to "constitute".

PUBLIC ACT 82-783 - EFFECTIVE: JULY 13, 1982

Revised reference to laws of Civil Procedure.

PUBLIC ACT 97-1129- EFFECTIVE: AUGUST 28, 2012

Added provisions for the Tax Tribunal.

PUBLIC ACT 98-463 - EFFECTIVE: AUGUST 16, 2013

Added “of 2012” to the reference to the Tax Tribunal Act.

SECTION 1202--VENUE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The Circuit Court of the county where the taxpayer has residency or commercial domicile shall review all final administrative decisions of the Department. The Circuit Court of Cook County will have final review for any taxpayer that has residency or commercial domicile outside of the state.

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AMENDED BY:

PUBLIC ACT 97-1129- EFFECTIVE: AUGUST 28, 2012

Added provisions for the Tax Tribunal.

PUBLIC ACT 98-463 - EFFECTIVE: AUGUST 16, 2013

Added “Independent” and “of 2012” to the reference to the Tax Tribunal Act.

SECTION 1203--SERVICE, CERTIFICATION AND DISMISSAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

A service upon the Director or the Assistant Director is considered served on the Department. A taxpayer may obtain a transcript of any proceedings at a specified cost.

AMENDED BY:

No amendments.

SECTION 1204--MODIFICATION OF ASSESSMENT

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

An assessment reviewed in accordance with this section is considered final.

AMENDED BY:

No amendments.

SECTION 1301--WILLFUL AND FRAUDULENT ACTS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any person who willfully attempts to evade or defeat the tax imposed by the IITA or who performs any fraudulent action is guilty of a misdemeanor and subject to fine and imprisonment.

AMENDED BY:

PUBLIC ACT 77-2222 - EFFECTIVE: JANUARY 1, 1973

Made the offense a Class B misdemeanor.

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PUBLIC ACT 79-908 - EFFECTIVE: SEPTEMBER 10, 1975

Added the statement that a prosecution for any act in violation of this section may be commenced at any time within 3 years of the commission of the act.

PUBLIC ACT 82-1009 - EFFECTIVE: SEPTEMBER 17, 1982

Amended charge to "Class A misdemeanor for the first offense and a Class 4 felony for each subsequent offense". Also extended the time for commencement of proceedings to 5 years.

PUBLIC ACT 83-1428 - EFFECTIVE: DECEMBER 1, 1984

Change charge for first offense to a Class 4 felony and for each subsequent offense to a Class 3 felony.

PUBLIC ACT 84-221 - EFFECTIVE: SEPTEMBER 1, 1985

Added provision that a person charged with a violation under this section shall be tried in the county of commercial domicile or residence unless right to another venue is asserted.

PUBLIC ACT 85-299 - EFFECTIVE: SEPTEMBER 9, 1987

Added provision that any accountant or other agent who knowingly enters false information on the return of any taxpayer is also liable under this section.

PUBLIC ACT 88-480 - EFFECTIVE: JANUARY 1, 1994

Reduces the act of filing a false return from a Class 4 felony to a Class A misdemeanor for the first offense and from a Class 3 felony to a Class 4 felony for each subsequent offense.

PUBLIC ACT 88-669 - EFFECTIVE: NOVEMBER 29, 1994

Revises the penalties for willful and fraudulent acts.

SECTION 1302--WILLFUL FAILURE TO PAY OVER

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any person who accepts money from a taxpayer to be paid to the Department and willfully fails to remit such payment is guilty of a misdemeanor subject to fine and imprisonment.

AMENDED BY:

PUBLIC ACT 77-2830 - EFFECTIVE: JANUARY 1, 1973

Changed the charge to a "Class B misdemeanor".

PUBLIC ACT 79-908 - EFFECTIVE: SEPTEMBER 10, 1975

Added the statement that a prosecution for any act in violation of this section may be commenced at any time within 3 years of the commission of the act.

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PUBLIC ACT 82-1009 - EFFECTIVE: SEPTEMBER 17, 1982

Extended the time for commencement of proceedings to 5 years.

PUBLIC ACT 83-1416 - EFFECTIVE: SEPTEMBER 13, 1984

Deleted language referring to a person making a payment to the Department knowing that the payment would not clear the bank. Also added language concerning the violation of the Criminal Code of 1961.

PUBLIC ACT 83-1428 - EFFECTIVE: DECEMBER 1, 1984

Changed charge to a Class A misdemeanor.

PUBLIC ACT 84-221 - EFFECTIVE: SEPTEMBER 1, 1985

Added provision that a person charged with a violation under this section shall be tried in the county of commercial domicile or residence unless right to another venue is asserted.

SECTION 1401--PROMULGATION OF RULES AND REGULATIONS

SECTION 1401(a)--IN GENERAL

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The Department has the authority to promulgate rules, regulations and forms as are necessary to properly enforce the Act.

AMENDED BY:

No amendments.

SECTION 1401(b)--UNITARY BUSINESS GROUPS

CREATED BY:

PUBLIC ACT 83-1289 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1985

Authorizes the Department to make rules, regulations and forms which are necessary to allow taxpayers (other than Subchapter S corporations) who are members of the same unitary group and have the same taxable year to file a combined return and report the sum of the group's liabilities on one return.

AMENDED BY:

PUBLIC ACT 84-221 - EFFECTIVE: SEPTEMBER 1, 1985

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Deleted the statement that the liability on the combined return was the sum of what would otherwise be the members' separate liabilities. Instead the Public Act incorporated the statement that the combined return liability was the group's tax liability under this Act.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Extended election to include members of unitary business groups (other than Subchapter S corporations) with differing year-ends to be included in the same combined return.

PUBLIC ACT 88-195 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1993

Changes the ELECTION for filing a combined return to a REQUIREMENT.

SECTION 1401(c)—OFFSETS AMONG MEMBERS OF UNITARY BUSINESS GROUPS

CREATED BY:

PUBLIC ACT 83-1289 - EFFECTIVE: RETROACTIVE TO AUGUST 1, 1969

The Department may make rules, regulations and forms as is necessary to allowance of offsets among taxpayers that are members of a unitary business group. For tax years for which unitary returns were filed prior to the availability of the combined return election, a taxpayer who is a member of unitary group may elect to have any overpayment due for a taxable year credited against the liability of one or more members of the group for the taxable year. An exception applies in that when an audit has been conducted, and overpayments have been determined to be due, an overpayment of one member of the group may be applied to the liabilities of other members of the group for any year in the audit period.

AMENDED BY:

No amendments.

SECTION 1402--NOTICE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Notices shall be sent by registered or certified mail to the person concerned at his last known address.

AMENDED BY:

PUBLIC ACT 97-0507-EFFECTIVE: AUGUST 23, 2011

Amended to allow notice by first-class mail.

SECTION 1403--SUBSTITUTION OF PARTIES

CREATED BY:

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PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If a person dies or becomes incompetent during any proceedings, the person's legal representative should inform the Department of such. The legal representative will then be substituted for the person.

AMENDED BY:

PUBLIC ACT 83-706 - EFFECTIVE: SEPTEMBER 23, 1983

Substituted "a person under legal disability" for "incompetent".

SECTION 1404--APPOINTMENT OF SECRETARY OF STATE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any person who leaves the state or conceals his whereabouts shall be deemed to have appointed the Secretary of State his agent for administrative proceedings.

AMENDED BY:

No amendments.

SECTION 1405--TRANSFEREES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Any liability of a transferee of property is assessed, paid and collected in the same manner and subject to the same limitations as in the case of the tax to which the liability relates. Also defines the term "transferee".

AMENDED BY:

PUBLIC ACT 81-1405 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1980

Deleted the phrase "and limitations". Also added an exception that "the period of limitations for the issuance of a Notice of Deficiency with respect to such liability shall be as provided in [current Section 905(m)]."

PUBLIC ACT 84-127 - EFFECTIVE: AUGUST 1, 1985

Includes in the definition of a "transferee", bulk purchasers under Section 902(d).

PUBLIC ACT 84-549 - EFFECTIVE: SEPTEMBER 18, 1985

Deletes devisee from the term "transferee".

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SECTION 1405.1--INFORMATION REPORTS

CREATED BY:

PUBLIC ACT 81-221 - EFFECTIVE: JANUARY 1, 1980

A person operating in Illinois and required to report to the US Treasury payments made to another person must also file a report with Illinois.

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Amends the section to reference Section 6050N of the IRC in addition to Section 6041. Also limits reporting requirements to payments of $1000 or more. Penalty is $1 per report up to a maximum of $25,000.

PUBLIC ACT 85-299 - EFFECTIVE: SEPTEMBER 9, 1987

Increased penalty to $5 per report up to a maximum of $25,000.

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deleted all language relating to the description of the penalty. This information is now contained in the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: September 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

Eliminates the requirement to file information reports. The reports must be maintained and be available for inspection by the Department.

SECTION 1405.2--INFORMATION REPORTS--PERSONAL SERVICE. CONTRACTS

CREATED BY:

PUBLIC ACT 85-299 - EFFECTIVE: PAYMENTS MADE ON OR AFTER JANUARY 1, 1989

Requires that information returns be filed on amounts in excess of $1,000 paid to nonresidents as a result of personal service contracts. The penalty for failing to file the report is $5 per report up to a maximum of $25,000.

AMENDED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deleted all language relating to the description of the penalty. This information is now contained in the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: September 24, 1992

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Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

Eliminates the requirement to file information reports. The reports must be maintained and be available for inspection by the Department.

SECTION 1405.3--INFORMATION REPORTS--PRIZES AND AWARDS

CREATED BY:

PUBLIC ACT 85-299 - EFFECTIVE: PAYMENTS MADE ON OR AFTER JANUARY 1, 1989

Requires that information returns be filed on amounts in excess of $1,000 paid to nonresidents as a prize or award. The penalty for failing to file the required reports is $5 per report up to a maximum of $25,000.

AMENDED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Deleted all language relating to the description of the penalty. This information is now contained in the Uniform Penalty and Interest Act.

PUBLIC ACT 87-1189 - EFFECTIVE: September 24, 1992

Delayed the effective date of the changes made by PA 87-205 until January 1, 1994.

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

Eliminates the requirement to file information reports. The reports must be maintained and be available for inspection by the Department.

SECTION 1405.4--REFUND INQUIRIES--RESPONSE

CREATED BY:

PUBLIC ACT 88-89 - EFFECTIVE: JUNE 30, 1995

Requires the Department to respond to refund inquiries in writing within 10 days of receiving the inquiry. The response must contain the date the inquiry was received, the file number assigned to the inquiry, and the name and telephone number of a Department employee whom the taxpayer may contact with further inquiries.

AMENDED BY:

PUBLIC ACT 97-0507-EFFECTIVE: AUGUST 23, 2011

Amended to eliminate the requirement of a written response and the opening of a file.

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SECTION 1405.5--REGISTRATION OF TAX SHELTERS

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Created requirement for tax shelter organizers to register each tax shelter with the Department.

AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Makes technical changes to reflect amendments to the IRC.

SECTION 1405.6--INVESTOR LISTS

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JUNE 30, 2004

Created requirement for tax shelter organizers who are required to maintain lists of investors under IRC Section 6112 to furnish to the Department copies of the information contained is such lists.

AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Makes technical changes to reflect amendments to the IRC and to change the definition of nexus with Illinois.

SECTION 1406--IDENTIFYING NUMBERS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

This section contains the Department's authority for requiring identifying numbers on returns, statements, reports, etc.

AMENDED BY:

No amendments.

SECTION 1407--AMOUNTS LESS THAN $1

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

Payments, refunds, etc. less than $1 may be disregarded. Amounts less than 50 cents will be disregarded and over 50 cents will be rounded to the next largest whole dollar amount.

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AMENDED BY:

No amendments.

SECTION 1408--ADMINISTRATIVE PROCEDURES ACT--APPLICATION

CREATED BY:

PUBLIC ACT 80-1172 - EFFECTIVE: JANUARY 4, 1978

The Illinois Administrative Procedures Act is adopted and shall apply to all administrative rules and procedures with some exceptions.

AMENDED BY:

PUBLIC ACT 88-45 - EFFECTIVE: JULY 6, 1993

Update references to the Illinois Administrative Procedure Act.

PUBLIC ACT 97-1129- EFFECTIVE; AUGUST 28, 2012

Added provisions for the Tax Tribunal.

PUBLIC ACT 98-463 - EFFECTIVE: AUGUST 16, 2013

Added “Independent” and 2012 to the reference to the Tax Tribunal Act.

SECTION 1501--DEFINITIONS

SECTION 1501(a)(1)--BUSINESS INCOME

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 92-846 - EFFECTIVE AUGUST 23, 2002

Provides that for years beginning on or after January 1, 2003, a taxpayer may elect to treat all income other than compensation as business income. This election, once made, shall be irrevocable.

PUBLIC ACT 93-840 - EFFECTIVE JULY 30, 2004

Changed definition of business income to mean all income that can be treated as apportionable under the federal Constitution.

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SECTION 1501(a)(1.5)--CAPTIVE REIT

CREATED BY:

PUBLIC ACT 95-233 - EFFECTIVE: AUGUST 16, 2007

Added this paragraph.

AMENDED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Amended paragraph to make technical corrections and to clarify the entities that are not treated as captive REITS despite meeting the basic definition.

PUBLIC ACT 96-641 - EFFECTIVE: AUGUST 24, 2009

Amended paragraph to clarify the entities that are not treated as captive REITS.

PUBLIC ACT 99-0213 - EFFECTIVE: JULY 31, 2015

Added subparagraph (D) to provide that interests in a REIT held in a segregated asset account of an insurance company are not taken into consideration in determining whether the REIT is a captive REIT.

SECTION 1501(a)(2)--COMMERCIAL DOMICILE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments.

SECTION 1501(a)(3)--COMPENSATION

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments.

SECTION 1501(a)(4)--CORPORATION

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

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AMENDED BY:

PUBLIC ACT 88-480 - EFFECTIVE: JANUARY 1, 1994

Adds limited liability companies, which are classified as corporations federally to the definition of a corporation.

SECTION 1501(a)(5)-DEPARTMENT

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments.

SECTION 1501(a)(6)--DIRECTOR

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments.

SECTION 1501(a)(7)--FIDUCIARY

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 83-706 - EFFECTIVE: SEPTEMBER 23, 1983

Deleted conservator from definition of a fiduciary.

SECTION 1501(a)(8)--FINANCIAL ORGANIZATION

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 83-217 - EFFECTIVE: SEPTEMBER 7, 1983

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Added a bank holding company and any person owned by a bank holding company to the definition of a financial organization.

PUBLIC ACT 89-711 - EFFECTIVE: DECLARATORY OF EXISTING LAW

Amends the definition of "financial organization" to include credit card banks and further define "sales finance company".

It also places some limits on the ability of taxpayers to receive refunds based on this clarification of law and allows taxpayers to elect out of the clarification provisions for Tax years beginning on or before 12/31/96 if certain election procedures are followed.

PUBLIC ACT 91-535 - EFFECTIVE: DECLARATORY OF EXISTING LAW

Section 1501(a)(8)(C)(i) amends the definition of “sales finance company”. The amended definition treats “credit”, “funding”, “loaning”, and “finance leasing” companies as sales finance companies. In order to qualify as a sales finance company, a person must be PRIMARILY ENGAGED in one or more of the following businesses: (1) Purchasing accounts receivable. This type of an entity is referred to as a “credit” company; (2) Making loans secured by customer receivables. This type of an entity is referred to as a “funding” company; (3) Making loans for the express purpose of funding purchases of tangible personal property. This type of an entity is referred to as a “loaning” company; and (4) Finance leasing. A lease is a finance lease if the lessee is treated as the owner of the asset and allowed a depreciation deduction under the Internal Revenue Code. This type of an entity is referred to as a “finance leasing” company.

Section 1501(a)(8)(C)(ii) establishes a fifth type of a company that qualifies as a sales finance company. In order to qualify as a sales finance company under this section, a company must: (1) Be a member of an affiliated group; (2) receive more than 50% of its gross income as interest income from qualifying loans; and (3) meet certain funding requirements.

SECTION 1501(a)(9)--FISCAL YEAR

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments.

SECTION 1501(a)(9.5)--FIXED PLACE OF BUSINESS

CREATED BY:

PUBLIC ACT 95-707 - EFFECTIVE: JANUARY 11, 2008

Added this paragraph.

SECTION 1501(a)(10)--INCLUDES/INCLUDING

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CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments.

SECTION 1501(a)(11)--INTERNAL REVENUE CODE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 76-2405 - EFFECTIVE: TAX YEARS ENDING AFTER JUNE 30, 1970

Substituted "existing on January 1, 1970" for "in effect on the date of the enactment of this Act".

PUBLIC ACT 77-726 - EFFECTIVE: FOR TAX YEARS ENDING AFTER JUNE 30, 1971

Substituted "or any successor law or laws relating to federal income taxes in effect for the taxable year" for "as amended and existing on January 1, 1970".

SECTION 1501(a)(11.5)--INVESTMENT PARTNERSHIPS

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Created definition of “investment partnership.”

SECTION 1501(a)(12)--MATHEMATICAL ERROR

CREATED BY:

PUBLIC ACT 78-796 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 30, 1973

AMENDED BY:

No amendments.

SECTION 1501(a)(13)--NONBUSINESS INCOME

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

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No amendments.

SECTION 1501(a)(14)--NONRESIDENT

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments.

SECTION 1501(a)(15)--PAID, INCURRED, ACCRUED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

No amendments.

SECTION 1501(a)(16)--PARTNERSHIP/PARTNER

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 86-953 - EFFECTIVE: NOVEMBER 30, 1989

Added the statement that for purposes of the Replacement Tax provisions of Section 201(c) of the Act, "...the term "partnership" does not include a syndicate, group, pool, joint venture or other unincorporated organization established for the sole purpose of playing the Illinois State Lottery."

PUBLIC ACT 88-480 - EFFECTIVE: JANUARY 1, 1994

Any entity, including a limited liability company formed under the Illinois Limited Liability Company Act, shall be treated as a partnership if it is so classified for federal income tax purposes.

PUBLIC ACT 91-913 - EFFECTIVE: JANUARY 1, 2001

Provides that a partnership that has made an IRC Section 761 election is not a partnership for Illinois purposes.

SECTION 1501(a)(17)--PART-YEAR RESIDENT

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CREATED BY:

PUBLIC ACT 77-2292 - EFFECTIVE: FOR TAX YEARS BEGINNING AFTER DECEMBER 31, 1970

AMENDED BY:

No amendments.

SECTION 1501(a)(18)--PERSON

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 86-905 - EFFECTIVE: SEPTEMBER 11, 1989

Added to the definition that an officer, agent or employee of a corporation, or a member, agent or employee of a partnership, who as such officer, agent, employee or member commits an offense specified in Section 1301 of the IITA.

PUBLIC ACT 88-480 - EFFECTIVE: JANUARY 1, 1994

Added limited liability companies to the definition of a "person". Also added that for purposes of Section 1301 and 1302, the term "person" includes "an officer, agent or employee of a corporation, a member, agent of employee of a partnership, or a member, manager, employee, officer, director or agent of a limited liability company who in such capacity commits an offense specified in Section 1301 and 1302."

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

Amends IITA definition of person to include corporations.

SECTION 1501(A)(18A)--RECORDS

CREATED BY:

PUBLIC ACT 88-480 - EFFECTIVE: JANUARY 1, 1994

AMENDED BY:

No amendments.

SECTION 1501(a)(19)--RETURNS--DELETED

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

DELETED BY:

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PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

SECTION 1501(a)(19)--REGULATIONS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

Renumbered subsection (a)(20) as (a)(19).

SECTION 1501(a)(20)--RESIDENT

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 77-2292 - EFFECTIVE: FOR TAX YEARS BEGINNING AFTER DECEMBER 31, 1970

Redefined the term "resident".

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Renumbered subsection (a)(21) as (a)(20).

SECTION 1501(a)(21)--SALES

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Renumbered subsection (a)(22) as (a)(21).

SECTION 1501(a)(22)--STATE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

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PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Renumbered subsection (a)(23) as (a)(22).

PUBLIC ACT 86-678 - EFFECTIVE: SEPTEMBER 1, 1989

For purposes of the Foreign Tax Credit of Section 601, "state" means any state of the United States, the District of Columbia, the commonwealth of Puerto Rico, and any territory or possession of the United States.

PUBLIC ACT 86-953 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1989

For purposes of the Foreign Tax Credit of Section 601, the term "state" also includes any political subdivision of any of the jurisdictions included in the PA 86-678 amendment.

SECTION 1501(a)(23)--TAXABLE YEAR

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Renumbered subsection (a)(24) as (a)(23).

SECTION 1501(a)(24)--TAXPAYER

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Renumbered subsection (a)(25) as (a)(24).

SECTION 1501(a)(25)--INTERNATIONAL BANKING FACILITY

CREATED BY:

PUBLIC ACT 82-661 - EFFECTIVE: TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1980

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Renumbered subsection (a)(26) as (a)(25).

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SECTION 1501(a)(26)--INCOME TAX RETURN PREPARER

CREATED BY:

PUBLIC ACT 82-1009 - EFFECTIVE: SEPTEMBER 17, 1982

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Renumbered subsection (a)(27) as (a)(26).

SECTION 1501(a)(27)--UNITARY BUSINESS GROUP

CREATED BY:

PUBLIC ACT 82-1029 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1982

The term "unitary business group" means a group of persons related through common ownership whose business activities are integrated with, dependent upon and contribute to each other. The group will not include those members whose business activity outside the United States is 80% or more of any such member's total business activity; for purposes of this paragraph and clause (a)(3)(B)(ii) of Section 304, business activity within the United States shall be measured by means of the factors ordinarily applicable under subsections (a), (b), (c), and (d) of Section 304 except that, in the case of corporations ordinarily required to apportion business income by means of the 3 factor formula of property, payroll and sales specified in subsection (a) of Section 304, such corporations shall not use the sales factor in the computation and the results of the property and payroll factor computations shall be divided by 2 (by one if either the property or payroll factor has a denominator of zero). Common ownership in the case of corporations is the direct or indirect control or ownership of more than 50% of the outstanding voting stock of the persons carrying on unitary business activity. Unitary business activity can ordinarily be illustrated where the activities of the members are: (1) in the same general line of business (such as manufacturing, wholesaling, retailing, insurance, transportation or finance); or (2) are steps in a vertically structured enterprise or process (such as the steps involved in the production of natural resources, which might include exploration, mining, refining, and marketing); and, in either instance, the members are functionally integrated through the exercise of strong centralized management (where, for example, authority over such matters as purchasing, financing, tax compliance, product line, personnel, marketing and capital investment is not left to each member). In no event, however, will a unitary group include both persons who are ordinarily required to apportion income by means of the 3 factor formula of property, payroll and sales and persons who are ordinarily required to apportion income by means of the single factors specified in subsection (b), (c) and (d) of Section 304.

AMENDED BY:

PUBLIC ACT 83-182 - EFFECTIVE: JANUARY 1, 1984

Changed the term "corporation" to "member" except in the "common ownership" sentence.

Further explained the 80/20 formula that should be used by members that are required to use one of the special apportionment formulas of Section 304.

Added that the term "retailing" refers to retailing of tangible personal property.

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Added a further definition that states that (for purposes of inclusion in a unitary business group) a member that is a 100% Illinois corporation should be considered to be required to use the apportionment formula that would it would be required to use if it were not a 100% Illinois corporation.

Finally, added the statement that a unitary group cannot be composed exclusively of 100% Illinois companies.

PUBLIC ACT 84-1400 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1986

Deleted the last sentence of the definition in order to allow the formation of a unitary business group that is composed exclusively of 100% Illinois companies.

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Amended the definition to provide that the restriction against the inclusion of members in a unitary group which apportion income under different subsections of Section 304 does not apply to groups composed of transportation companies and a transportation holding company or groups composed of insurance companies and an insurance company holding company. Renumbered subsection (a)(28) as (a)(27).

PUBLIC ACT 90-613 - EFFECTIVE: JULY 9, 1998

Added Section 304(h), single factor sales apportionment formula, to the Unitary Business Group definition. Also, added the provision that if the unitary business group's accounting period differ, the common parent's accounting period, or if there is no common parent, the accounting period of the member that is expected to have, on a recurring basis, the greatest Illinois income tax liability must be used to determine whether to use the apportionment method provided in Section 304(a) or (h). The prohibition against membership in a unitary business group for taxpayers ordinarily required to apportion income under different subsections of Section 304 does not apply to taxpayers required to apportion income under Section 304(a) and (h). These provisions apply to tax years ending on or after December 31, 1998.

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Amended subsection (a)(27) to provide that “United States” for the purposes of the 80-20 test means only the 50 states and the District of Columbia, but does not include any territory or possession of the United States or any area over which the United States has asserted jurisdiction or claimed exclusive rights with respect to the exploration for or exploitation of natural resources.

PUBLIC ACT 97-0507-EFFECTIVE: AUGUST 23, 2011

Amended exception to the non-combination rule for certain holding companies to apply to financial organizations and multiple holding companies, and to allow splitting of holding companies among groups.

PUBLIC ACT 97-636- EFFECTIVE: DECEMBER 16, 2011

Adds reference to new subsection 304 (c-1), for federally-regulated exchanges.

PUBLIC ACT 100-22 – EFFECTIVE JULY 6, 2017

Repealed the noncombination rule an expanded the definition of "United States" to include the outer continental shelf.

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SECTION 1501(a)(28)--SUBCHAPTER S CORPORATION

CREATED BY:

PUBLIC ACT 83-1352 - EFFECTIVE: SEPTEMBER 8, 1984

Added subsection (a)(29) to define “Subchapter S corporation.”

AMENDED BY:

PUBLIC ACT 85-731 - EFFECTIVE: FOR TAX YEARS ENDING ON OR AFTER DECEMBER 31, 1987

Renumbered subsection (a)(29) as (a)(28).

SECTION 1501(a)(30)--FOREIGN PERSON

CREATED BY:

PUBLIC ACT 93-840 - EFFECTIVE: JULY 30, 2004

Added subsection (a)(30) to define “foreign person.”

SECTION 1501(b)--OTHER DEFINITIONS

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

For any words denoting number: if singular, denote plural also; and if plural, denote singular. Any words denoting gender apply to the opposite sex as well. The term’s "company" and "association" include successors and assigns.

AMENDED BY:

No amendments.

SECTION 1502--ARRANGEMENT AND CAPTION

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

The grouping or captions of any sections of the IITA should infer no meaning.

AMENDED BY:

No amendments.

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SECTION 1601--SEVERABILITY

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

If any one part of the Act is determined to be unconstitutional, the remainder of the Act remains in effect.

AMENDED BY:

No amendments.

SECTION 1701--EFFECTIVE DATE

CREATED BY:

PUBLIC ACT 76-261 - EFFECTIVE: AUGUST 1, 1969

"This Act shall take effect August 1, 1969."

AMENDED BY:

No amendments.

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UNIFORM PENALTY AND INTEREST ACT

UNIFORM PENALTY AND INTEREST ACT -- 35 ILCS 735/3-1 et seq.
FROM: ILLINOIS REVISED STATUTES CH 120 PARAGRAPH. 2603-1 et seq.

SECTION 3-1--TITLE

SECTION 3-1A--REFERENCES

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

The UPIA applies to all taxes administered by the Department of Revenue except, the Racing Privilege Tax Act, the Revenue Act of 1939, the Real Estate Transfer Tax Act and the Coin Operated Amusement Device Tax Act.

AMENDED BY:

No amendments.

SECTION 3-2--INTEREST

SECTION 3-2(a)--INTEREST RATES

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Interest is charged taxpayers and paid to taxpayers at the same rate, which will be established by the IRC.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

PUBLIC ACT 93-32 - EFFECTIVE: JUNE 20, 2003

Beginning January 1, 2004, interest paid on deficiencies or overpayments will be at the federal short-term rate for the first year interest accrues and at the federal underpayment rate thereafter.

PUBLIC ACT 98-425 - EFFECTIVE: AUGUST 16, 2013

Provides that interest accruing after December 31, 2013, will be at the federal underpayment rate.

SECTION 3-2(b)--INTEREST RATE ADJUSTMENTS

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CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Interest will be adjusted semi-annually.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-2(c)--INTEREST CALCULATIONS

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Interest is calculated as simple interest on a daily rate on tax and penalty due. If tax due is paid within 10 days of issuance of a Notice and Demand, interest will not accrue for the time period after the Notice and Demand.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

Increased the number of days in which a notice and demand can be paid in full without additional interest accruing from 10 days to 21 days.

PUBLIC ACT 89-379 - EFFECTIVE JANUARY 1, 1996

Increases the interest grace period to 30 days (was 21 days).

PUBLIC ACT 91-803 - EFFECTIVE: JANUARY 1, 2001

Amended subsection (c) to state that it is applicable to returns due on and before December 31, 2000.

SECTION 3-2(c-5)--INTEREST CALCULATIONS FOR RETURNS DUE ON OR AFTER JANUARY 1, 2001

CREATED BY:

PUBLIC ACT 91-803 - EFFECTIVE: JANUARY 1, 2001

Provides that interest shall only accrue on the amount of the unpaid tax.

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SECTION 3-2(d)--INTEREST ON OVERPAYMENTS

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

This section discusses when interest will not be paid on overpayments, what happens when an unprocessable return is received, when interest begins to accrue on overpayments and restricted interest procedures for Illinois net loss carrybacks.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-2(e)--ERRONEOUS REFUND INTEREST

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Interest on erroneous refunds will generally accrue from the date of the refund was issued.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-2-(f) 2003 AMNESTY

CREATED BY:

PUBLIC ACT 93-26 - EFFECTIVE: JUNE 20, 2003

Doubles interest on liabilities qualified for amnesty and not paid under amnesty.

AMENDED BY:

PUBLIC ACT 96-1435 - EFFECTIVE: AUGUST 16, 2010

Amended subsection to apply only to the 2003 amnesty.

SECTION 3-2-(g) – 2010 AMNESTY

CREATED BY:

PUBLIC ACT 96-1435 - EFFECTIVE: AUGUST 16, 2010

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Doubles interest on liabilities, other than estimated federal changes, qualified for amnesty and not paid under the 2010 amnesty.

SECTION 3-2(h) – 2010 AMNESTY

CREATED BY:

PUBLIC ACT 96-1435 - EFFECTIVE: AUGUST 16, 2010

Provides that no interest is payable on refunds allowed under the amnesty act.

SECTION 3-3--PENALTY FOR FAILURE TO FILE OR PAY

SECTION 3-3(a), (a-5), (a-10), (a-15)--PENALTY FOR FAILURE TO FILE

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

A 5% penalty is imposed for failure to file a timely return unless the return is filed within 21 days of notice of failure to file by the Department.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

Rewrote the late filing penalty to be imposed on any return which is not filed by the prescribed due date. The basis for the penalty is the tax required to be shown due on the return. If an unprocessable return is filed timely, the late filing penalty will be assessed only if the unprocessable return is not perfected within 21 days of notice by the Department.

PUBLIC ACT 89-379 - EFFECTIVE: JANUARY 1, 1996

Rewrote the late filing penalty for returns due on or after 1/1/96 to provide that the penalty is equal to 2% of the tax required to be shown due on the return, up to a maximum of $250 for failing to file a timely return. The penalty base is equal to the tax required to be shown without considering timely made payments or Article 2 credits.

In addition, if any return is not filed within 30 days of the issuance of a notice of nonfiling, an additional penalty will be imposed equal to $250 or 2% of the tax shown on the return up to a maximum of $5,000. The penalty base is equal to the tax shown without considering timely made payments or Article 2 credits.

Finally, the late filing penalty will not be imposed if the taxpayer has a 2-year good filing record, however, this exception does not apply to annual returns such as income tax returns or annual withholding filers but it would apply to all other withholding filers.

PUBLIC ACT 91-803 - EFFECTIVE: JANUARY 1, 2001

Amends subsection (a-5) to state that it is applicable to returns due on or after January 1, 1996 and on or before December 31, 2000.

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Added subsection (a-10) which provides that for returns due on or after January 1, 2001 that the Tier 1 late filing penalty is 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. The Tier 2 late filing penalty remains unchanged, and continues to apply to the tax due without reduction for timely payments or credits.

PUBLIC ACT 98-425 - EFFECTIVE: AUGUST 16, 2013

Added subsection (a-15), which imposes a penalty of $100 for each failure to file a transaction return.

PUBLIC ACT 99-335 - EFFECTIVE: AUGUST 10, 2015

Amended subsections (a-10) and (a-15) to make clear that the same failure to file could not be subject to penalty under both subsections.

SECTION 3-3(b)--PENALTY FOR FAILURE TO PAY

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

A 15% (or 20% in the case of a trust tax) penalty is imposed for failure to pay timely, the amount shown on the return or the amount required to be shown on the return.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994. Rewrote the late payment penalty to eliminate the trust tax penalty rate. The subsection (b)(1) penalty is imposed on any failure to pay the tax shown due on the return on or before the date prescribed for payment including any estimated tax payments and any liability reflected on an amended return (other than a timely filed and paid amended return reporting a federal change) Subsection (b)(2) was rewritten to impose the late payment penalty on any additional amount of tax due which is not paid within 21 days of a notice and demand, within the protest period on a defaulted notice of deficiency, or within 21 days of a final determination date in the case of a protest notice of deficiency.

PUBLIC ACT 88-480 - EFFECTIVE: JANUARY 1, 1994

Made minor changes to the references in the section.

PUBLIC ACT 89-436 - EFFECTIVE JANUARY 1, 1996

Extends the grace period for payment of an audit tax liability prior to application of the late payment penalty to 30 days (was 21 days).

SECTION 3-3(b-5)--PENALTY FOR FAILURE TO FILE OR PAY

CREATED BY:

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PUBLIC ACT 90-548 - EFFECTIVE: FOR RETURNS DUE ON OR AFTER JANUARY 1, 1998.

Increased the late payment penalty to 20% (was 15%). Amended (b) to apply only to returns due prior to January 1, 1998.

AMENDED BY:

PUBLIC ACT 91-803 - EFFECTIVE: JANUARY 1, 2001

Amends subsection (b-5) to state that it is applicable to returns due on or after January 1, 1998 and on or before December 31, 2000.

SECTION 3-3(b-10)--PENALTY FOR FAILURE TO FILE OR PAY

CREATED BY:

PUBLIC ACT 91-803 - EFFECTIVE: JANUARY 1, 2001

Amends subsection (b-5) to state that it is applicable to returns due on or after January 1, 1998 and on or before December 31, 2000.

Adds subsection (b-10) to provide that for returns due on or after January 1, 2001 a penalty for failure to pay shall be imposed. Subsection (b-10)(1) provides that the penalty for late payment or nonpayment of admitted liability is calculated at increasing rates based on the number of days the payment is late. Subsection (b-10)(2) provides that the penalty for late payment or nonpayment of additional liability, within 30 days after a notice of arithmetic error, notice and demand, or a final assessment is issued by the Department is 20% of any amount that is not paid within the 30 day period.

AMENDED BY:

PUBLIC ACT 92-742 - EFFECTIVE: JULY 25, 2002

Amends this section by providing that if a notice and demand is made for the payment of any amount of the tax due and if the amount due is paid within 30 days after the date of notice and demand, then the penalty for late payment or nonpayment of admitted liability on the amount so paid shall not accrue for the period after the date of the notice and demand.

PUBLIC ACT 93-32 - EFFECTIVE: JUNE 20, 2003

Amends the section to apply only to returns due on or after January 1, 2001 and prior to January 1, 2004.

SECTION 3-3(b-15)--PENALTY FOR FAILURE TO FILE OR PAY

CREATED BY:

PUBLIC ACT 93-32 - EFFECTIVE: JUNE 20, 2003

For returns due on or after January 1, 2004, imposes a late payment penalty of 5% to 20% (for payments more than 180 days late) and an underreporting penalty of 5% (for liabilities not reported on a timely original return) to 20% (for liabilities not reported on an original or amended return prior to assessment by the Department).

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AMENDED BY:

PUBLIC ACT 93-1068 - EFFECTIVE: JANUARY 15, 2005

Made subsection (b-15)(1) apply only for returns due on or after January 1, 2004 and before January 1, 2005, and deleted subsection (b-15)(2).

SECTION 3-3(b-20)--PENALTY FOR FAILURE TO FILE OR PAY

CREATED BY:

PUBLIC ACT 93-1068 - EFFECTIVE: JANUARY 15, 2005

Enacted subsection (b-20) effective for returns due on or after January 1, 2005.

SECTION 3-3(c)--BASIS OF FAILURE TO PAY PENALTY

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

The late payment penalties are reduced by any tax paid timely.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-3(d)--REDUCTION OF FAILURE TO FILE/PAY PENALTIES

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Penalty is applied on the amount required to be shown on return even if it is less than amount shown on return.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-3(e)--OFFSET OF FAILURE TO PAY PENALTIES

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

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If a penalty is applied on the amount shown on the return filed, the additional failure to pay penalty is only applied on the additional amount found due.

AMENDED BY:

PUBLIC ACT 91-803 - EFFECTIVE: JANUARY 1, 2001

Amends subsection (e) to provide that it is applicable to returns due before January 1, 2001 and to add references to subsections (b-5)(1) and (2).

Adds subsection (e-5) which provides that for returns due on or after January 1, 2001 that if both a subsection (b-10)(1) penalty and a subsection (b-10)(2) penalty are assessed against the same return, the subsection (b-10)(2) penalty shall be assessed against only the additional tax found to be due.

SECTION 3-3(f)--BEST INFORMATION AVAILABLE

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

If no return is filed the Department will use the best information available to compute a liability.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-3(g)--TRUST TAX

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Contains a definition of trust taxes.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

Deleted all provisions relating to trust taxes. Added a provision, which states that the time period for paying tax due without imposition of a penalty does not extend the time within which a protest can be filed in response to a notice of deficiency.

SECTION 3-3(h)--OMISSION OF INFORMATION

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PUBLIC ACT 90-491 - EFFECTIVE JANUARY 1, 1998

No return will be determined to be unprocessable because of an omission of any information requested pursuant to Section 39b53 of the Civil Administrative Code of Illinois.

SECTION 3-3(i) 2003 AMNESTY

CREATED BY:

PUBLIC ACT 93-26 - EFFECTIVE: JUNE 20, 2003

Doubles penalties related to liabilities qualified for amnesty and not paid under amnesty.

AMENDED BY:

PUBLIC ACT 96-1435 - EFFECTIVE: AUGUST 16, 2010

Amended subsection to apply only to the 2003 amnesty.

SECTION 3-3(j) – 2010 AMNESTY

CREATED BY:

PUBLIC ACT 96-1435 - EFFECTIVE: AUGUST 16, 2010

Doubles penalties on liabilities, other than estimated federal changes, qualified for amnesty and not paid under the 2010 amnesty.

SECTION 3-4--PENALTY FOR FAILURE TO FILE INFO RETURNS

SECTION 3-4(a)--IMPOSITION OF PENALTY

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

This section contains the rate of the penalty and a description of what failures are subject to penalty.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-4(b)--REDUCTION OF PENALTY

CREATED BY:

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PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

This section contains a limitation on the amount of penalty imposed and when the penalty can be reduced.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-4(c)--INFORMATION RETURN

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

This section defines “information return”.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-4(d) 2003 AMNESTY

CREATED BY:

PUBLIC ACT 93-26 - EFFECTIVE: JUNE 20, 2003

Doubles penalties related to liabilities qualified for amnesty and not paid under amnesty.

AMENDED BY:

PUBLIC ACT 96-1435 - EFFECTIVE: AUGUST 16, 2010

Amended subsection to apply only to the 2003 amnesty.

SECTION 3-4(e) – 2010 AMNESTY

CREATED BY:

PUBLIC ACT 96-1435 - EFFECTIVE: AUGUST 16, 2010

Doubles penalties on liabilities, other than estimated federal changes, qualified for amnesty and not paid under the 2010 amnesty.

SECTION 3-4.5--COST OF COLLECTION PENALTY

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CREATED BY:

PUBLIC ACT 93-32 - EFFECTIVE: JUNE 20, 2003

For returns due on or after July 1, 2003, imposes a penalty for failure to pay a liability owed by the taxpayer within 30 days after receiving a bill for the amount. The penalty is $30 for unpaid amounts of less than $1,000 and $100 for unpaid amounts of $1,000 or more.

SECTION 3-5--PENALTY FOR NEGLIGENCE

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

In addition to any penalty imposed under Section 3-3, a 10% penalty is applied to any deficiency resulting from a negligently prepared return.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

Increased the penalty rate from 10% to 20% of any resulting deficiency. Changed the definition of negligence.

PUBLIC ACT 93-26 - EFFECTIVE: JUNE 20, 2003

Created 3-5(d), which doubles penalties related to liabilities qualified for amnesty and not paid under amnesty.

PUBLIC ACT 96-1435 - EFFECTIVE: AUGUST 16, 2010

Amended subsection (d) to apply only to the 2003 amnesty. Added subsection (e) to double penalties on liabilities, other than estimated federal changes, qualified for amnesty and not paid under the 2010 amnesty.

SECTION 3-6--PENALTY FOR FRAUD

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

In addition to any penalty imposed under Section 3-3, a 50% penalty is applied to any fraudulently filed return or claim.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

PUBLIC ACT 93-26 - EFFECTIVE: JUNE 20, 2003

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Created 3-6(c), which doubles penalties related to liabilities qualified for amnesty and not paid under amnesty.

PUBLIC ACT 96-1435 - EFFECTIVE: AUGUST 16, 2010

Amended subsection (c) to apply only to the 2003 amnesty. Added subsection (d) to double penalties on liabilities, other than estimated federal changes, qualified for amnesty and not paid under the 2010 amnesty.

SECTION 3-7--PERSONAL LIABILITY PENALTY

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

For any trust tax, a penalty equal to the amount of tax, interest and penalty unpaid by a taxpayer shall be imposed on any officer or employee of the taxpayer who has the control, supervision or responsibility of filing returns and making payments.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

Added subsection (f), which contains a definition of a trust tax.

PUBLIC ACT 88-480 - EFFECTIVE: JANUARY 1, 1994

Added limited liability companies to the entities for which a personal liability penalty may be applied.

PUBLIC ACT 89-399 - EFFECTIVE: AUGUST 20, 1995

Amends the Personal Liability Penalty provisions to require surety bonds in Administrative Review cases.

Also, adds Section 3.7(g) which states that the personal liability imposed by this section is in addition to liability incurred by a partner of a partnership or limited liability partnership resulting from the issuance of a notice of tax liability issued to the partnership or limited liability partnership.

PUBLIC ACT 90-458 - EFFECTIVE AUGUST 17, 1997

Amends the Personal Liability Penalty provisions regarding surety-bonding requirements in administrative review cases. (Unknown changes).

PUBLIC ACT 91-203 - EFFECTIVE: JULY 20, 1999

Added Section 3-7(h) to provide that any amount collected as a tax or represented as a tax is held in trust for the Department, so that failure to pay over that amount is subject to the Section 3-7 personal liability.

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SECTION 3-7.5--BAD CHECK PENALTY

CREATED BY:

PUBLIC ACT 91-803 - EFFECTIVE: JANUARY 1, 2001

Creates Section 3-7.5 which provides that in addition to any other penalty a penalty of $25 shall be imposed on any person who issues a check or other draft to the Department that is not honored upon presentment on or after January 1, 2001.

AMENDED BY:

PUBLIC ACT 93-26 - EFFECTIVE: JUNE 20, 2003

Created 3-7.5(b), which doubles penalties related to liabilities qualified for amnesty and not paid under amnesty, and renumbered existing Section 3-7.5 as Section 3-7.5(a).

PUBLIC ACT 96-1435 - EFFECTIVE: AUGUST 16, 2010

Amended subsection (b) to apply only to the 2003 amnesty. Added subsection (c) to double penalties on liabilities, other than estimated federal changes, qualified for amnesty and not paid under the 2010 amnesty.

SECTION 3-8--REASONABLE CAUSE ABATEMENT

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

The penalties imposed under Sections 3-3 and 3-4 shall be abated if reasonable cause exists. Reasonable cause will be determined prior to imposition of the penalty. Sections 3-3 and 3-4 penalties can be protested without protesting the underlying tax liability.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

Added Section 3-5 penalties to those, which could be abated by reasonable cause.

PUBLIC ACT 91-803 - EFFECTIVE: JANUARY 1, 2001

Amended Section 3-8 to add a reference to Section 3-7.5.

SECTION 3-9--APPLICATION OF PROVISIONS

SECTION 3-9(a)--INTEREST

CREATED BY:

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PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

UPIA interest provisions apply to rates of interest for periods on and after the effective date of the UPIA.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-9(b)--PENALTIES

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Penalties are imposed at the rate and in the manner in effect at the time the tax liability became due.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-9(c)--INTEREST ON CLAIMS

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Interest on claims filed after the effective date of the UPIA will be paid in accordance with the UPIA.

AMENDED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-9(d)--PAYMENT APPLICATION

CREATED BY:

PUBLIC ACT 87-205 - EFFECTIVE: JANUARY 1, 1993

Payments received from the taxpayer will be applied to the outstanding tax, penalty and interest of any outstanding, agreed to liability.

AMENDED BY:

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PUBLIC ACT 87-1189 - EFFECTIVE: SEPTEMBER 24, 1992

Delayed the effective date of the provisions of PA 87-205 until January 1, 1994.

SECTION 3-10--LIMITATIONS

The provisions contained in Section 3-10 were originally included in the Civil Administrative Code of Illinois (20 ILCS 2505/39c-4). The provisions were created by PA 87-1246 and were effective January 1, 1993. Section 39c-4(f) contains a repealed clause for January 1, 1994.

SECTION 3-10(a)--FALSE OR FRAUDULENT RETURNS

CREATED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: JANUARY 1, 1994

In the case of a false or fraudulent return, tax may be assessed at any time.

AMENDED BY:

No amendments.

SECTION 3-10(b)--REASONABLE CAUSE

CREATED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: JANUARY 1, 1994

If the taxpayer can show reasonable cause for not filing a return, the period for which tax can be assessed is limited to not more than 6 years after the original due date of each return required to have been filed.

AMENDED BY:

No amendments.

SECTION 3-10(c)--VOLUNTARY DISCLOSURE

CREATED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: JANUARY 1, 1994

If the failure to file a return is voluntarily disclosed, the tax may be assessed no more than 4 years after the original due date of each return required to have been filed.

AMENDED BY:

No amendments.

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SECTION 3-10(d)--NOTIFICATION BY DEPARTMENT

CREATED BY:

PUBLIC ACT 87-1189 - EFFECTIVE: JANUARY 1, 1994

The limitations on assessment shall not apply if the Department has, within the 6-year period, notified the taxpayer that a return is required.

AMENDED BY:

No amendments.

SECTION 3-11--DEPARTMENT AND TAXPAYER STUDY

CREATED BY:

PUBLIC ACT 89-379 - EFFECTIVE: JANUARY 1, 1996

Requires the Department to conduct a study of effectiveness of the current penalty structure as a means of ensuring timely filing of returns and payment of tax. The study will be completed and presented to the General Assembly no later than January 1, 2000.

SECTION 3-12--APPEAL OPTIONS

PUBLIC ACT 89-597 - EFFECTIVE AUGUST 1, 1996

Requires the Department to include a statement of appeal options (available either by law or by departmental rule) for each penalty being applied.

AMENDED BY:

PUBLIC ACT 97-1129- EFFECTIVE: AUGUST 28, 2012

Added provisions for the Tax Tribunal.

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37. COURT CASE SYNOPSES

This chapter contains synopses of the various court cases, which have been referred to in the other chapters of this manual. A few other cases whose decisions may have had some effect on the Illinois taxation laws have been included. These summaries have been provided to give the reader a general idea of the main issues involved in each of the cases and the reasoning that led to the decisions made. A case citation is provided to enable the reader to obtain the complete decision in various reference books which available in most large public libraries.

The synopses are arranged in alphabetical order by the common name associated with the case and appear that way in the TABLE OF CONTENTS. In situations in which multiple cases involving the same taxpayer are included, a year or state identifier has been added to the heading.

At the end of each synopsis a CROSS REFERENCE and a TOPICAL INDEX reference is made. The CROSS REFERENCE refers to the chapters in the manual in which this case has been referred to, quoted and/or listed. The TOPICAL INDEX field contains the major issues of the case. An index is included in this chapter which groups the case decisions by the topics which appear in this field.

JURISDICTION OF THE CASE DECISIONS

A decision of an Illinois Circuit Court is only binding on THE SPECIFIC PARTIES INVOLVED IN THE SUIT. Illinois Appellate Court decisions have jurisdiction over all cases, which are, heard IN THAT APPELLATE COURT DISTRICT. Illinois Supreme Court decisions have jurisdiction over cases which are heard throughout the State and US Supreme Court decisions have jurisdiction over cases which are heard throughout the country. Decisions of other states' courts are not binding on Illinois cases, however, they may provide information regarding issues which may not have been decided in Illinois courts at this time.

ADMINISTRATIVE REVIEW AND JUDICIAL REMEDIES

If a taxpayer disagrees with the result of an audit, a written protest of the Notice of Deficiency must be submitted within 60 days of its issuance. Once the protest is received, the audit file is forwarded to the Administrative Hearing Section for disposition. The rules pertaining to hearing procedures are contained in Regulation Sections 200.101 through 200.175. If a taxpayer disagrees with the Department's final administrative decision, a complaint may be filed with the (Illinois) Circuit Court. A Circuit Court decision may be appealed to the Illinois Appellate Court, the Illinois Supreme Court and, ultimately, the US Supreme Court.

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A taxpayer may choose to forego the Administrative Hearings process and take a case directly to Circuit Court. In these cases, the liability must first be Paid under Protest and a suit must be filed in Circuit Court within 30 days of the date the Payment under Protest is made, in accordance with the provisions of the Protest Act which are contained in Illinois Revised Statutes, Chapter 127, Paragraphs 172 and 172a.

NOTE: See Chapter 32 for more information regarding unsettled audits and payments under protest.

EXPLANATION OF CASE CITATIONS

All large libraries contain reference materials relating to the judicial system and case decisions. If the case name and approximate date of the decision is known, the Decennial Digest Table of Cases can be used to find sources that contain the case decision.

The Decennial Digest (so called because they were originally published every ten years, although now they are published every five years and are denoted Part 1 and Part 2) and most citations in any literature, will describe the reference source in an abbreviated form. The key to finding the case is understanding the abbreviations. Some of the more common abbreviations follow:

REFERENCE SOURCES	ABBREVIATIONS
Supreme Court Reporter	SCt
Federal Reporter	F
Federal Reporter 2nd Series	F2d
Federal Supplement	F Supp
United States Reporter	US
Illinois Reporter	Ill
Illinois Reporter 2nd Series	Ill 2d
Illinois Appellate Court Reporter	Ill App
Illinois Appellate Court Reporter 2nd Series	Ill App 2d
Illinois Appellate Court Reporter 3rd Series	Ill App 3d
Atlantic Reporter	A
California Reporter	Cal Rptr
North eastern Reporter	NE
Pacific Reporter 2nd Series	P2d
Southeastern Reporter	SE
Southwestern Reporter	SW
U.S. Tax Cases	USTC

The first number of the citation relates to the volume of the reference source and the last number relates to the page number for the start of the case with the exception of those citings from U.S. Tax Cases. This source is published by CCH and references all types of Federal tax cases. The Citation will refer to a volume number and paragraph.

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CITATION EXAMPLES

325 F Supp 857 - Volume 325 of the Federal Supplement begins on page 857.

5 SCt 601 - Volume 5 of the Supreme Court Reporter begins on page 601.

113 US 516 - Volume 113 of the United States Reporter beginning on page 516.

64-2 USTC 9858 - Volume 64-2 of the U.S. Tax Cases, paragraph 9858.

If a citation includes a parenthetical number or phrase it normally denotes the year (or date) of the decision and the geographical jurisdiction of the court. If no court is cited (Appellate or Circuit), then the decision is that of the highest court in the jurisdiction shown. For example, 676 P2d 595 (Alaska 1984) means that the case can be found in volume 676 of the Pacific Reporter second edition, starting at page 595 and that this decision was made by the Alaska Supreme Court in 1984.

A decision in the Federal Supplement denotes a district court decision (like a state circuit court); a decision in the Federal Reporter represents a decision of the Court of Appeals; and a decision in the United States Reporter or Supreme Court Reporter represents a decision of the United States Supreme Court. Citation references to the US Reporter can also be found in the Supreme Court Reporter.

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Adams Express v. Ohio State Auditor (1897) - 165 US 194, 17 SCt 305.

Alaska Department of Revenue v. Amoco Production Co. (1984) - 676 P2d 595.

Arizona v. Talley Industries, Inc.,

Montana v. ASARCO, Inc. (1977) - 567 P2d 901.

ASARCO, Incorporated v. Idaho State Tax Commission (1982) – 458 US 307, 73 L Ed 2d 787, 102 SCt 3103.

Bass, Ratcliff, & Gretton, Ltd. v. New York State Tax Commission (1924) - 266 US 271.

Butler Brothers v. McColgan (CA) (1942) - 315 US 501, 62 SCt 701.

Caterpillar Tractor Co., et al, v. Daniel Lenckos (1981) – 84 Ill 2d 102.

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Chase Brass & Copper Co. v. FTB (1970) - 10 Cal App 3d 496, 87 Cal Rptr 239.

Citizens Utilities Company of Illinois v. Department of Revenue (1986) - 111 Ill 2d 32.

Coca-Cola Company v. Oregon Department of Revenue (1975) – 533 P2d 788.

Container Corporation of America v. FTB (1983) - 463 US 159, 77 L Ed 2d 545, 103 SCt 2933.

John Deere Plow Company of Moline v. FTB (1951) - 38 Cal2d 214, 238 P2d 569.

Edison California Stores v. McColgan (1947) - 30 Cal2d 472, 183 P2d 16.

Exxon Corp. v. Wisconsin Department of Revenue (1980) - 447 US 207, 65 L Ed 2d 66, 100 SCt 2109.

Filtertek, Inc. v. Illinois Department of Revenue (1989) – 186 Ill App 3d 208.

Hans Rees' Sons v. State of North Carolina (1931) - 283 US 123, 51 SCt 389.

Honolulu Oil Corp. v. FTB (1963) - 386 P2d 40, 34 Cal Rptr 552.

Lakehead Pipeline Company v. Illinois Department of Revenue 1989) - 192 Ill App 3d 756.

Miami Corporation v. Illinois Department of Revenue (1991) – 212 Ill App 3d 702.

Mobil Oil Corp. v. Commissioner of Taxes of Vermont (1980) - 445 US 425, 63 L ED 2d 510, 100 SCt 1223.

Moorman Manufacturing Company v. G. D. Bair (1978) - 437 US 267, 57 L ED 2d 197, 98 SCt 2340.

North American Cement v. Grover (NY, 1936) - 199 NE 510.

Norfolk & Western Railway Company v. State of North Carolina ex rel. Maxwell (1936) - 297 US 682, 50 SCt 625.

Ott v. Mississippi Valley Barge Line Company, et al. (1949) - 336 US 169, 69 SCt 432.

Shell Oil Company vs. Department of Revenue, State of Florida (1986) - 496 So 2d 789.

Shell Oil Company v. Iowa Department of Revenue (1988) - 488 US 278.

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Shell Oil Company, et al v. Illinois Department of Revenue (1993) - Circuit Court of Cook County, Docket Number 91 L 50905.

Standard Register Company v. Franchise Tax Board (CA, 1968), 259 Cal App 2d 125, 66 Cal Rptr 803.

Superior Oil v. Franchise Tax Board (CA), 60 Cal 2d 406, 386 P2d 33.

Underwood Typewriter Company v. Chamberlain (Conn., 1920) – 41 SCt 45, 254 US 113.

Union Pacific Railway Co. v. Ryan (Wyoming, 1885) - 5 SCt 601, 113 US 516.

F. W. Woolworth Co. v. Taxation & Revenue Department of New Mexico (1982) - 458 US 354, 73 L ED 2d 819, 102 SCt 3128.

BURDEN OF PROOF

Balla v. Illinois Department of Revenue (1981) - 96 Ill App 3d 293.

CLAIMS

Lewis v. Reynolds (1932) - 284 US 281, 52 SCt 145.

FEDERAL TAXABLE INCOME

Chicago Title and Trust Co. v. Department of Revenue (1986) - 100 Ill Dec 502, 146 Ill App 3d 923.

Madison Park Bank v. Zagel (1982) - 91 Ill 2d 231.

FOREIGN TAXES PAID

Caterpillar Tractor Co., et al, v. Daniel Lenckos (1981) - 84 Ill 2d 102.

FOREIGN SOURCE DIVIDENDS

Kraft, Inc. v. Iowa Department of Revenue and Finance (1992) - 112 SCt 2365.

INDIVIDUALS - NONRESIDENTS

Shaffer v. Carter (Oklahoma, 1920) - 252 US 37.

MATH ERROR

Illinois Department of Revenue v. William J. Walsh (1990) - 196 Ill App 3d 772.

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NET OPERATING LOSSES

Bodine Electric Company v. Robert H. Allphin (1980) - 81 Ill 2d 502.

Caterpillar Tractor Company v. J. Thomas Johnson (1987) - 117 Ill 2d 454, 512 NE2d 1240.

Chicago Title and Trust Co. v. Department of Revenue (1986) - 100 Ill Dec 502, 146 Ill App 3d 923.

Madison Park Bank v. Zagel (1982) - 91 Ill 2d 231.

Searle Pharmaceuticals, Inc. v. The Department of Revenue and Caterpillar Tractor Co. et al. v. J. Thomas Johnson (1987) - 117 Ill 2d 454.

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Hervey v. AMF Beaird (1971) - 250 Ark 147, 464 SW2d 557.

American Refrigerator Transit Company v. Oregon State Tax Commission (1964) - 395 P2d 127.

Amway Corporation, Inc. v. Missouri Director of Revenue (1990), 794 SW2d 666.

Appeal of Aqua Aerobic Systems Inc., CAL SBE 11/6/85, CCH

California State Income Tax Reporter, Para. 401-172.

Atlas Foundry & Machine Company v. Oregon State Tax Commission (1965) - 2 OTR 200.

Complete Auto Transit v. Brady (1977) - 430 US 274.

Fontenot (Louisiana) v. John I. Hay Company (1955) - 228 La 1031, 84 So2d 810.

Geldermann and Company Inc. v. Oregon State Tax Commission - Oregon Tax Court, No. 2000, July 2, 1985.

Herff Jones Company v. Oregon (1965) - 430 P2d 998.

Iron Fireman Manufacturing Co. v. Oregon (1968) - 445 P2d 126.

Wisconsin v. J.C. Penney Co. (1940) - 311 US 435.

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Appeal of Joyce, Inc., CAL SBE 11/23/66, CCH California State Income Tax Reporter, 1966 Cal Tax LEXIS 18.

Japan Line, Ltd. v. County of Los Angeles (1979) - 441 US 434, 99 SCt 1813.

Northwestern States Portland Cement Co. v. Minnesota (1959) - 358 US 450.

Smith, Kline & French Laboratories v. Oregon State Tax Commission (1964) - 403 P2d 375.

Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951)

NONBUSINESS INCOME

Allied-Signal, Inc. as Successor-In-Interest to the Bendix Corporation v. New Jersey Director of Taxation (1992) - 112 SCt 2251.

Montana v. ASARCO, Inc. (1977) - 567 P2d 901.

ASARCO, Incorporated v. Idaho State Tax Commission (1982) - 458 US 307, 73 L ED 2d 787, 102 SCt 3103.

Atlantic Richfield Company v. The State of Colorado (1979) - 601 P2d 628.

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National Realty and Investment Co. v. Ill. Department of Revenue (1986) - 144 Ill App 3d 541.

R. L. Qualls, Director, Arkansas Department of Finance and Administration v. Montgomery Ward & Company (1979) - 266 Ark 207, 585 SW2d 18.

Sperry & Hutchinson Company v. Oregon Department of Revenue (1974) - 270 OR 329, 527 P2d 729.

Appeal of Standard Oil of California, California SBE (1983) -

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Tipperary Corporation v. New Mexico (1979) - 595 P2d 1212.

F. W. Woolworth Co. v. Taxation & Revenue Department of New Mexico (1982) - 458 US 354, 73 L ED 2d 819, 102 SCt 3128.

OIL AND GAS COMPANIES

Madison Gas and Electric Company v. Commissioner of Internal Revenue (1979) - 72 TC 521.

Miami Corporation v. Illinois Department of Revenue (1991) – 212 Ill App 3d 702.

Shell Oil Company vs. Department of Revenue, State of Florida (1986) - 496 So 2d 789.

Shell Oil Company v. Iowa Department of Revenue (1988) - 488 US 278.

Shell Oil Company, et al v. Illinois Department of Revenue (1993) - Circuit Court of Cook County, Docket Number 91 L 50905.

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Chen et al. v. Illinois Department of Revenue (1990) - 145 Ill App 3d 520, 495 NE2d 1124.

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Illinois Department of Revenue v. William J. Walsh (1990) – 196 Ill App 3d 772.

PHOTOCOPYING INFORMATION

Boren v. Tucker, (1956, CA9) - 239 F2d 767, 50 AFTR 1217, 57-1

USTC.

People v. Floom (1977) - 52 Ill App 3d 971.

PIPELINES

Lakehead Pipeline Company v. Illinois Department of Revenue (1989) - 192 Ill App 3d 756.

PROPERTY FACTOR - LEASES

Alaska Department of Revenue v. Amoco Production Co. (1984) - 676 P2d 595.

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Mt. Mansfield Television Inc. v. US (2nd Cir., 1965) - 342 F2d 994, 65-1 USTC Para. 9270.

PROPERTY FACTOR - INTANGIBLE DRILLING COSTS

Atlantic Richfield Company v. Oregon (1986) - 717 P2d 613.

Shell Oil Company vs. Department of Revenue, State of Florida (1986) - 496 So 2d 789.

Shell Oil Company, et al v. Illinois Department of Revenue (1993) - Circuit Court of Cook County, Docket Number 91 L 50905.

SALES FACTOR - INTEREST

Continental Illinois National Bank and Trust Co. of Chicago v. Lenckos (1984) - 102 Ill 2d 210, 105 SCt 296.

SALES FACTOR - ADVERTISING REVENUES

New Yorker Magazine, Inc. v. Department of Revenue of Illinois (1989) - 187 Ill App 3d 931.

SALES FACTOR - THROWBACK SALES

Filtertek, Inc. v. Illinois Department of Revenue (1989) – 186 Ill App 3d 208.

Appeal of Finnigan Corp., CAL SBE 8/25/88 - CCH California State Income Tax Reporter, Para. 401-653, rehearing reaffirmed 1988 decision, 1/24/90.

GTE Automatic Electric, Inc. v. Allphin (1977) - 68 Ill 2d 326.

Appeal of Joyce, Inc., CAL SBE 11/23/66, CCH California State Income Tax Reporter, 1966 Cal Tax LEXIS 18.

SALES FACTOR - IN-STATE DELIVERY TO AN OUT-OF-STATE PURCHASER

McDonnell Douglas Corporation v. Franchise Tax Board, California Court of Appeal, Second Appellate District, Division Four, No. B064073, July 7, 1994, 26 CA 4th 1789, 26 CA 4th 808, 31 Crptr 712, modified August 8, 1994.

SECTION 78 GROSS-UP

Caterpillar Tractor Co. v. Lenckos (1979) - 32 IllDec786, 77 Ill App 3d 90, affirmed 49 IllDec329, 84 Ill 2d 102, appeal dismissed 103 SCt 3562.

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STATUTE OF LIMITATIONS

Caterpillar Tractor Company v. J. Thomas Johnson (1987) - 117 Ill 2d 454, 512 NE2d 1240.

Dow Chemical v. Illinois Department of Revenue (1991) - 224 Ill App 3d 263, 586 NE2d 516.

The Holding Company v. Illinois Department of Revenue (1991) - 214 Ill App 3d 390.

La Pine Scientific Company v. Lenckos (1981) - 95 Ill App 3d 955, 420 NE2d 655.

Lewis v. Reynolds (1932) - 284 US 281, 52 SCt 145.

Searle Pharmaceuticals, Inc. v. The Department of Revenue and Caterpillar Tractor Co. et al. v. J. Thomas Johnson (1987) - 117 Ill 2d 454.

Illinois Department of Revenue v. William J. Walsh (1990) – 196 Ill App 3d 772.

SUBPART F INCOME

Caterpillar Tractor Co. v. Lenckos (1979) - 32 IllDec786, 77 Ill App 3d 90, affirmed 49 IllDec329, 84 Ill 2d 102, appeal dismissed 103 SCt 3562.

Kraft, Inc. v. Roger D. Sweet (1991) - 213 Ill App 3d 889.

SUBPOENA

United States v. Acker (1971) - 325 F Supp 857.

Boren v. Tucker, (1956, CA9) - 239 F2d 767, 50 AFTR 1217, 57-1 USTC.

Department of Revenue v. Continental Illinois Bank & Trust Company (1975) - Ill App 3d 326.

United States v. Davey (1976) - 543 F2d 996.

Firestone Tire and Rubber Company v. FTB (1978) - 87 Cal App 3d

878, 151 Cal Rptr 460.

People v. Floom (1977) - 52 Ill App 3d 971.

Multistate Tax Commission v. Merck and Company (Ore SCt 1980), 617 P2d 1371.

United States et al. v. Powell et al. (1964) - 64-2 USTC Para. 9858.

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Multistate Tax Commission (MTC) v. US Steel Corporation (1980) - 434 US 452, 98 SCt 799.

TANGIBLE PROPERTY

Farrand Coal v. Halpin (1957) - 10 Ill 2d 507.

Keystone Consolidated Industries v. Allphin (1977) - 45 Ill App 3d 714.

United Artists Corporation v. Taylor (New York, 1937), 273 NY 334, 7 NE2d 254, affirming 248 app. div. 207, 288 NYS 946.

Walt Disney Productions v. United States - (71-2 USTC Para. 9507), 327 FSupp 189 Affirmed as Modified, (73-2 USTC Para. 9484), 480 F2d 66, Cert. Denied.

Walt Disney Productions v. United States (74-2 USTC Para. 9623), (76-2 USTC Para. 9606) Affirming and Remanding District Court Decision (77-1 USTC Para. 9398) (As Amended).

TAX EXEMPT INTEREST - AMORTIZATION

Continental Illinois National Bank and Trust Co. of Chicago v. Lenckos (1984) - 102 Ill 2d 210, 105 SCt 296.

Moline National Bank v. Illinois Department of Revenue, Plainfield National Bank v. Illinois Department of Revenue (1983) - 111 Ill App 3d 1086.

TRANSPORTATION COMPANIES

Fontenot (Louisiana) v. John I. Hay Company (1955) - 228 La 1031, 84 So2d 810.

Hygrade Furniture Transport, Inc. v. New York Tax Commission (1986) - TSB-H-86(16)C; Corporation Tax.

State of Illinois v. Commonwealth of Kentucky (1991) - 111 SCt 1877.

Lakehead Pipeline Company v. Illinois Department of Revenue (1989) - 192 Ill App 3d 756.

Norfolk & Western Railway Company v. State of North Carolina ex rel. Maxwell (1936) - 297 US 682, 50 SCt 625.

Ott v. Mississippi Valley Barge Line Company, et al. (1949) - 336 US 169, 69 SCt 432.

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Adams Express v. Ohio State Auditor (1897) - 165 US 194, 17 SCt 305.

Arizona v. Talley Industries, Inc.,

Montana v. ASARCO, Inc. (1977) - 567 P2d 901.

ASARCO, Incorporated v. Idaho State Tax Commission (1982) – 458 US 307, 73 L ED 2d 787, 102 SCt 3103.

Barber-Greene Company, Barber-Green Americas and B-G-S Engineering, Inc. v. Illinois Department of Revenue (1987) - No. MR KA '84 0095 (Cir. Ct. Ill., June 4, 1985), aff'd No. 2-85-0108 (Ct. App. Ill., October 28, 1986), petition denied February 6, 1987 by Illinois Supreme Court.

Bass, Ratcliff, & Gretton, Ltd. v. New York State Tax Commission (1924) - 266 US 271.

Butler Brothers v. McColgan (CA) (1942) - 315 US 501, 62 SCt 701.

Caterpillar Tractor Co., et al, v. Daniel Lenckos (1981) – 84 Ill 2d 102.

Chase Brass & Copper Co. v. FTB (1970) - 10 Cal App 3d 496, 87 Cal Rptr 239.

Citizens Utilities Company of Illinois v. Department of Revenue (1986) - 111 Ill 2d 32.

Coca-Cola Company v. Oregon Department of Revenue (1975) – 533 P2d 788.

Container Corporation of America v. FTB (1983) - 463 US 159, 77 L ED 2d 545, 103 SCt 2933.

John Deere Plow Company of Moline v. FTB (1951) - 38 Cal2d 214, 238 P2d 569.

Edison California Stores v. McColgan (1947) - 30 Cal2d 472, 183 P2d 16.

Exxon Corp. v. Wisconsin Department of Revenue (1980) - 447 US 207, 65 L ED 2d 66, 100 SCt 2109.

Filtertek, Inc. v. Illinois Department of Revenue (1989) – 186 Ill App 3d 208.

Appeal of Finnigan Corp., CAL SBE 8/25/88 - CCH California State Income Tax Reporter, Para. 401-653, rehearing reaffirmed 1988 decision, 1/24/90

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Honolulu Oil Corp. v. FTB (1963) - 386 P2d 40, 34 Cal Rptr 552.

Louis Dreyfus Corp. v. Joe B. Huddleston, Commissioner of Revenue, State of Tennessee, Tennessee Chancery Court, 20th Judicial District, Davidson County, No. 93-830-III, October 3, 1994 (Order was entered October 13, 1994).

Mobil Oil Corp. v. Commissioner of Taxes of Vermont (1980) - 445 US 425, 63 L ED 2d 510, 100 SCt 1223.

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Superior Oil v. Franchise Tax Board (CA), 60 Cal 2d 406, 386 P2d 33.

State of Arizona v. Talley Industries, Inc., (1994) – Arizona Court of Appeals, Division One, Department T, No. 1 CA-TX 92-0013.

F. W. Woolworth Co. v. Taxation & Revenue Department of New Mexico (1982) - 458 US 354, 73 L ED 2d 819, 102 SCt 3128.

US INTEREST

Smith et al. v. Davis et al. (1944) - 323 US 111, 65 SCt 157.

US INTEREST - FHLB DIVIDENDS

Bell Federal Savings and Loan Association v. Illinois Department of Revenue (1982) - 111 Ill App 3d 890.

US INTEREST - FSLIC REFUNDS

Bell Federal Savings and Loan Association v. Illinois Department of Revenue (1982) - 111 Ill App 3d 890.

US INTEREST - GNMA/FNMA

Citizens State Bank of Mount Morris v. J. Thomas Johnson (1985) - 130 Ill App 3d 925.

Farmers and Traders State Bank v. J. Thomas Johnson (1984) – 76 Ill Dec 565, 121 Ill App 3d 43.

Montgomery Ward Life Insurance Co. v. Department of Local Government Affairs (1980) - 89 Ill App 3d 292.

Rockford Life Insurance Company v. Illinois Department of Revenue et al. (1986) - 112 Ill 2d 174.

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US INTEREST - MUTUAL FUNDS

Andras v. Illinois Department of Revenue (1987) - 154 Ill App 3d 37, cert. denied 116 Ill 2d 547, US cert. denied 108 SCt 1223.

US INTEREST - REPURCHASE AGREEMENTS

Andras v. Illinois Department of Revenue (1987) - 154 Ill App 3d 37, cert. denied 116 Ill 2d 547, US cert. denied 108 SCt 1223.

First American National Bank of Nashville v. United States of America (1972) - [72-2 USTC Para. 9694], 467 F2d 1098.

VALUATION LIMITATION SUBTRACTION

Chen et al. v. Illinois Department of Revenue (1990) - 145 Ill App 3d 520, 495 NE2d 1124.

Illinois Department of Revenue v. William J. Walsh (1990) - 196 Ill App 3d 772.

SYNOPSES

A. B. DICK CORPORATION

A.B. Dick Corp. v. Illinois Department of Revenue Sangamon County Circuit Court. January 5, 1996.

This case resolves the issue surrounding the filing status of A.B. Dick Company and Videojet Systems International. It was determined by the Court that under the Illinois Income Tax Act Section 1501(a)(27), the two companies could not be considered a unitary business entity. The Court held that there was a lack of fundamental integration in the key areas of manufacturing, marketing, engineering, purchasing, advertising and distribution.

CROSS REFERENCE:

TOPICAL INDEX:

AARON RENTS INC.

Aaron Rents, Inc. v. Georgia State Department of Revenue. Superior Court. June 27, 1994.

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This case resolves the issue surrounding the allocation and apportionment of income of Aaron Rents Inc. The Georgia State Department of Revenue asserted that Aaron Rents established a subsidiary company, Aaron Investment Company, for the sole purpose of evading their proper tax liability. The Commissioner reallocated income from the subsidiary to the parent company and assessed the tax liability based on the total income of both corporations. Aaron Rents petitioned the Court to review the actions of the Commissioner and to address the arbitrary shifting of income issue that this case was predicated on.

The Georgia Department of Revenue issued a notice for a demand payment to Aaron Rents for the fiscal year ending March 31, 1989. The impetus behind the notice involved the Department's determination that Aaron Rent's subsidiary, Aaron Investment Company, should be reallocated to Aaron Rents in order to reflect Aaron Rents Georgia taxable income more accurately. The Department relied on O.C.G.A. section 48-2-59 in generating its assessment and demand for payment. Aaron Rents would not comply with the notice based on the fact that their subsidiary was incorporated for a number of valid non-tax reasons and that they were separate and distinct entities. The Court agreed with Aaron Rents' assertion.

The Court held that the formation of Aaron Investment Company served a variety of purposes. They found that it protected and enhanced value of Aaron Rents' trademarks and service marks. The incorporation also segregated Aaron Rents' trademarks from the company's other assets so that Aaron Rents could quantify how much money they were making off the name Aaron Rents. Aaron Investments also protected the transferred intangibles against the claims of Aaron Rents' creditors. These were a few of the reasons that the Court reversed the decision of the Commissioner. The Court determined that Aaron Investment functioned as a separate and distinct corporation. The Court held that Aaron Investment maintained separate headquarters, bank accounts, and corporate contract name. The Court also recognized the fact that Aaron Investment incurred operating costs, held and managed intangible assets and stock, has its own corporate officers and board of Directors, and collected income and paid taxes. It was for these several reasons the Court decided the case in favor of Aaron Rents Inc. It found that Aaron Rents met its burden to show that there were valid non- tax reasons for establishing Aaron Investment Company, and that Aaron Investment Company has engaged in sufficient business activities to constitute a valid, separate and distinct corporate entity.

CROSS REFERENCE:

TOPICAL INDEX:

ABKCO INDUSTRIES, INC.

Abkco Industries v. Commissioner of Internal Revenue. United States Tax Court. August 18, 1971.

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Abkco Industries filed a petition with the Tax Court seeking for a review of a decision rendered by the Commissioner of Internal Revenue. The Commissioner recomputed the income of ABKCO Industries for the short taxable period December 22 to Dec. 31, 1961, which was closed by the statute of limitations. The Commissioner contended that a recomputation was permissible for the purpose of determining the amount of a 1964 net operating loss carryback absorbed in that short taxable year, in order to determine the remaining amount of the carryback available in a subsequent open year. After the recomputation of income, the Commissioner issued notices of increased deficiencies for the tax years 1962 and 1963 respectively. The issues in this case are twofold. The first question presented in the case was whether the Commissioner may increase ABKCO'S 1962 deficiency on the basis of his recomputation of their taxable income for a prior period which was closed by the statute of limitations. The second issue was whether ABKCO, an accrual basis taxpayer, may deduct in 1962 and 1963 certain royalty expenses accrued on its books during such years with respect to its sale of phonograph records.

The Court held that the Commissioner was entitled to disallow a deduction that ABKCO claimed on their return for the short taxable period December 22 to December 31, 1961, and thereby reduce the portion of the 1964 net operating loss carryback. The Court contended that the Commissioner recomputed ABKCO's short period income only for the purpose of determining its income tax liability for 1962, and that the statute of limitations is not a bar to such recomputation. The support for the Commissioner's position was found in section 6214(b) in the Internal Revenue Code and in a substantial body of case law.

The second issue for decision was whether, in the short taxable period December 22 to 31, 1961, and in the calendar years 1962 and 1963, the Abkco company may accrue royalties computed but not yet paid under paragraph 6 of its agreement with Matz and Evans. The Court stated that under the accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred which determine the fact of the liability. The Court concluded that Abkco's liability for the royalties in question were so contingent and uncertain that accrual is impermissible and that the Commissioner's determination must be sustained.

CROSS REFERENCE:

TOPICAL INDEX:

ACKER

United States v. Acker (1971) - 325 F Supp 857.

The IRS called upon Acker, as Secretary of Standard Oil Company of New Jersey ("Jersey"), to produce minutes of meetings held in 1962 and 1963 by the board of directors and executive committees of Jersey itself and 17 affiliated corporations which were included in the Jersey's consolidated federal income tax returns. Acker refused to comply.

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The court ruled that:

* Demand in an IRS summons may extend to documents that might throw light on subjects under legitimate inquiry and agents cannot and need not guarantee that everything they wish to see will be relevant or material;

* IRS need not show cause or probable cause to justify summons for documents;

* IRS summons was sufficiently definite and limited, without further specification, although many pages of minutes would not bear on tax liabilities; corporation was not entitled to determine what parts of minutes might be relevant and material; and

* IRS summons was not void under the Fourth Amendment (Due Process Clause).

CROSS REFERENCE: Chapter 35 - Subpoenas

TOPICAL INDEX: Subpoena

ADAMS EXPRESS

Adams Express v. Ohio State Auditor (1897) - 165 US 194, 17 SCt 305.

The main relevance of this property tax decision is that it appears to have originated the phrase "unity of use". The "standard unity of substance" which existed in prior case decisions (relating to railroads) was replaced in this case "by one of unity of use and management."

The US Supreme Court recognized the worth of combined assets: "The unit is a unit of use and management, and the horses, wagons, safes, pouches and furniture...possessed a value in combination..."

CROSS REFERENCE: Chapter 35 – Apportionment

TOPICAL INDEX: Apportionment/Unitary

ALLIED-SIGNAL

Allied-Signal, Inc. as Successor-In-Interest to the Bendix Corporation v. New Jersey Director of Taxation (1992) - 112 SCt 2251.

The case involved the New Jersey income tax liability of Allied-Signal, Inc. fka Bendix Corporation ("Allied") for the fiscal year ending September 30, 1981, as it related to the gain realized on Allied's sale of ASARCO stock. New Jersey statutes have no provision

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for non-business income, nor does New Jersey allow combined apportionment. All income which is "unitary" to the company's operations in New Jersey must be included in appaortionable income.

New Jersey and Allied stipulated that no unitary relationship existed between Allied and ASARCO. However, New Jersey maintained that the gain on the sale of ASARCO stock should be included in apportionable income since, in the State's opinion, the investment in ASARCO went beyond a passive investment and Allied was in business of buying and selling corporations. Also, New Jersey believed that the income should be included in apportionable income since Allied intended to use the proceeds from the stock sale to acquire the stock of another company whose business activities were complimentary to Allied's business operations.

Allied disagreed, taking the position that since there was no unitary relationship between Allied and ASARCO, New Jersey was precluded from including the gain on the sale of stock in apportionable income.

The US Supreme Court found in favor of Allied. The Court held that:

* The unitary business principle remains an appropriate device for ascertaining whether a State has transgressed constitutional limitations in taxing a nondomiciliary corporation. There is no reason to overturn the prior decisions in the case of ASARCO and Woolworth and to do so would create confusion and chaos for the taxpayers that have relied on those decisions in reporting their state income tax liabilities and for the states that have structured their statutes based on those decisions.

As stipulated by Allied and New Jersey, no unitary relationship existed between Allied and ASARCO.

* The unitary business rule is "...a recognition of the States' wide authority to devise formulae for an accurate assessment of a corporation's intrastate value or income and the necessary limit on the States' authority to tax value or income that cannot fairly be attributed to the taxpayer's activities within the State."

New Jersey's theory that all income of a corporation doing business in that state is, by virtue of common ownership, part of the corporation's unitary business and is apportionable is unreconcilable with this rule.

* The payer and payee of the income need not be engaged in the same unitary business for the income to be apportionable, but the capital transaction must serve an operational rather than an investment function. The existence of a unitary relationship between the payer and the payee is just one justification for apportioning the income.

"We did not purport...to establish a general requirement that there be a unitary relation between the payer and the payee to justify apportionment, nor do we do so today."

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The Court supported the UDITPA standard for business/non-business income that business income is income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

However, since New Jersey provided very little support for this position, the standard was not applied in this case.

The Court also stated that the mere fact that an intangible asset was acquired pursuant to a long-term corporate strategy of acquisitions and dispositions did not convert an otherwise passive investment into an integral operational one. Finally, the Court held that the ASARCO stock which was held for over two years could not be considered a short-term investment of working capital.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Non-business Income

AMERICAN HOME PRODUCTS CORPORATION

American Home Products Corp. v. Tax Commissioner of Ohio Supreme Court. March 7, 1990.

American Home Products appealed a decision made by the Ohio Board of Tax Appeals. The controversy in the case stemmed from the apportionment of taxable income of the American Home Products Corporation by the Tax Commissioner of Ohio. The Commissioner contended that the short-term investment income acquired by AHP, was used for operating capital and therefore could be apportioned to Ohio for tax purposes. This was the point of contention in the case. The company was headquartered in New York and acquired, managed and controlled its investment there. Although four manufacturing plants located in Ohio provided a nexus which created corporate franchise tax liability in Ohio, only that portion of the investment income which was used as working capital for its interstate business could be apportioned to Ohio.

American Home Products Corp. maintained that they did not use the any portion of the non-unitary investments and securities as security to borrow working capital or directly as operational capital. The company also argued that the Due Process Clause prohibited Ohio's taxation of the non-unitary investment income because the investment activity producing the income took place entirely outside Ohio and because the payers were discrete business entities. The Commissioner responded to that claim by stating that the income was available as working capital, even though it was not needed, and apportioning the income to Ohio did not violate the Due Process Clause. The Court held that the taxing and re- apportionment of the investment income received by American Home Products,

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was unconstitutional. The Court reversed the decision of the Ohio State Board of Tax Appeals.

CROSS REFERENCE:

TOPICAL INDEX:

AMERICAN REFRIGERATOR TRANSIT COMPANY

American Refrigerator Transit Company v. Oregon State Tax Commission (1964) - 395 P2d 127.

The case examined the propriety of the imposition of a net income tax on an entity involved in a service (leasing) operation. The Oregon Supreme Court held that the connection necessary to establish nexus between a state and a foreign entity is essentially an economic rather than a physical relationship. A state is free to exact a reasonable tribute from those persons using its economic resources. These resources include the maintenance of conditions essential to the production or marketing of goods. The Court found that the leasing of railroad cars to and under the control of other corporations is sufficient contact with the state to create nexus. Therefore, the income received from leasing the cars on a miles-traveled basis is taxable by the state in which the miles are traveled.

American Refrigerator owned refrigerator cars which it leased to operating railroads. It was not a public carrier, it issued no bills of lading and it published no tariffs of rates for shippers. The taxpayer's sole activity in the transportation field was to rent refrigerator cars to operating railroads for their use in performing their own transportation service for their own shippers under their own tariffs and shipping documents.

American Refrigerator contended that it had no property "located or having a situs" in Oregon, and did not carry on any activity in the State. The State approached the issue of nexus based on an economic relationship rather than the physical relationship plaintiff contended. The Court agreed with the state and held that American Refrigerator's cars had a "situs" in Oregon since the cars were used in the exploitation of the market in Oregon from which American Refrigerator derived income through its rental of cars. The Court further stated that it is now firmly established that a state may tax the net income of a corporation engaged exclusively in interstate commerce even though the taxpayer has no offices or agents within the taxing state, if it could be shown that the state's economy was a substantial economic factor in the production of the taxpayer's income.

CROSS REFERENCE: Chapter 36

TOPICAL INDEX: Nexus

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AMF BEAIRD

Hervey v. AMF Beaird (1971) - 250 Ark 147, 464 SW2d 557.

The Arkansas Supreme Court concluded that making regular inventory checks as well as taking orders and accepting payments was a sufficient amount of activity by representatives in the taxing state to make a foreign corporation subject to income tax.

AMF manufactured gas storage tanks. Its representatives' only activities in Arkansas were to accept payments from the Arkansas retailers and check their inventories. The inventory checks were to designed to protect AMF's contract interest, property rights, and interest in accurate billing. The Court held that the representatives' activities went beyond the "solicitation" protected by PL 86-272, which (the Court said) should be narrowly construed.

CROSS REFERENCE: Chapter 36

TOPICAL INDEX: Nexus

AMOCO PRODUCTION COMPANY

Alaska Department of Revenue v. Amoco Production Co. (1984) - 676 P2d 595.

The case covered major issues:

* The propriety of using the separate accounting method, and

* The computation of the property apportionment factor.

The Alaska Supreme Court found that the fact that some income from sales could be geographically segregated was insufficient to warrant separate accounting. Amoco had apportioned a substantial part of its overhead expenses which were incurred outside of Alaska in computing Alaska net income, giving a strong indication (as seen by the Court) of a heavy dependence on management and technical services performed outside of the state. The Court ruled that Amoco's Alaska income was not sufficiently separate and distinct from and unconnected with its income earned outside of Alaska to warrant separate accounting.

Amoco had also contended that non-producing leaseholds should not be included in the property factor of the apportionment formula. The basis of this argument was that non-producing oil and gas leases did not constitute property used for the production of income. The Court found that these leases should be included in the property factor since they were examples of "non-obvious contributions" to Amoco's production of income.

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"The exploration and development of what later turn out to be unproductive oil or gas wells is a necessary and integral part of Amoco's eventual discovery and exploration of productive oil and gas wells. To say that only property values associated with oil and gas leases which are known to contain recoverable quantities of oil and gas should be included within the property factor is to ignore the ability to derive oil and gas income."

CROSS REFERENCE: Chapter 35 - Oil & Gas

TOPICAL INDEX: Apportionment/Property Factor - Leases

AMWAY CORPORATION, INC.

Amway Corporation, Inc. v. Missouri Director of Revenue (1990), 794 SW2d 666.

Amway manufactured and sold a variety of products through door-to-door sales. These sales were conducted by distributors who purchased the products from Amway and resold the products to the consumers. In addition to selling the Amway products, the distributors also recruited other individuals to become Amway distributors. Individuals paid an initial fee to become a distributor and also paid an annual fee to renew the distributorship. Amway had no factories, sales offices or employees in Missouri.

Amway maintained that their products were being sold by independent, self-employed distributors who purchased the products from Amway at wholesale and resold the products at retail. The application form for a distributorship stated that there was no agency or representative relationship between the individual and the company. The distributors' earnings were based on the margin by which the retail price of the product exceeds the wholesale cost.

Distributors also earned money through sales to other distributors they had recruited. The company encouraged its distributors to solicit the sale of distributorships. Each distributorship was, however, a separate agreement between the individual and Amway.

Amway took the position that it was a seller of tangible personal property and was, therefore, protected by PL 86-272. Since, in Amway's opinion, the distributors were independent salespeople rather than employees or representatives of the company, the distributors activities in Missouri did not exceed the limitations of PL 86-272 and Missouri had no right to impose an income tax on Amway.

The Missouri Supreme Court found that:

* The sale of distributorships by the Amway distributors constituted a sale of a "nonexclusive franchise" which was a sale of intangible personal property. Amway was not, therefore, strictly a seller of tangible personal property and was not afforded the protection of PL 86-272.

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* The distributors were not independent salespeople because, in addition to selling Amways products, they were authorized to solicit the sales of new distributorships. They were, therefore, Amway's representatives.

Amway had also contended that the recruiting of new distributors was merely a method of "spurring sales" and was not an activity separate from the company's product sales. The Court disagreed:

"[I]t is not the quantity of activity that determines whether [PL 86-272] is a shield against state income tax liability. The statutory prohibition on taxation is determined by the quality of the activity; specifically, activity which is limited to the solicitation of the sale of tangible personal property.

Doubtless the sale of distributorships spurred product sales, but it also generated significant income for Amway independent of the sale of any tangible products...The solicitation of the sale of distributorships was not an isolated or transient event, but an ongoing activity to produce income separate from the sale of products or merchandise.

The volume of sales is not the key to deciding whether [PL 86-272] shields Amway from Missouri income tax. The shield is only available so long as Amway and its representatives did no more than solicit the sale of tangible personal property. Even though the activity may have been secondary to spurring product sales, the shield evaporated when Amway, through its distributors, solicited the sale of the distributorships."

CROSS REFERENCE: Chapter 36

TOPICAL INDEX: Nexus

ANDRAS

Andras v. Illinois Department of Revenue (1987) - 154 Ill App 3d 37, cert. denied 116 Ill 2d 547, US cert. denied 108 SCt 1223.

The Illinois Appellate Court held that dividend income attributable to a mutual fund's holdings in US government obligations is exempt from the shareholder's adjusted base income in computing IITA. The Court further held that the repurchase agreements were actually loans secured by the securities. The interest received by the mutual fund from these repurchase agreements, and the subsequent dividend income paid to the shareholders of the trust, was not exempt from state taxation.

The Department asked the US Supreme Court to review the decision, however, the Supreme Court denied review in March 1988.

CROSS REFERENCE: Chapter 29

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TOPICAL INDEX: US Interest - Mutual Funds/US Interest – Repurchase Agreements

AQUA AEROBIC SYSTEMS, INC.

Appeal of Aqua Aerobic Systems Inc., CAL SBE 11/6/85, CCH California State Income Tax Reporter, Para. 401-172.

The California State Board of Equalization (SBE) adopted a narrow interpretation of solicitation in holding that an Illinois company was subject to franchise tax in California because its activities within the state exceeded those permitted by P.L. 86-272.

Aqua Aerobic warranted repairs during three of the subject years and then limited its activities within California to sales start-up supervision for the last tax year in question. P.L. 86-272 immunizes from state tax those companies engaged in interstate commerce whose activities within a state are limited to "solicitation" of sales. The SBE found that Aqua Aerobics' performance of the warranty repair work was not mere solicitation of sales. Rather, it was considered a consequence of prior sales and, therefore, exceeded the bounds set by P.L. 86-272.

The SBE also found that the sales start-up supervision exceeded mere "solicitation" of sales. Aqua Aerobic described this activity as a sales technique, which consisted of a sales person visiting the job site to see that the equipment being sold was in proper condition prior to its operation. The SBE felt that this was an activity that followed as a result of a sale, since the service was performed after the products were installed. In addition, the activity seemed to involve a complete inspection of the equipment sold since an employee of Aqua Aerobic spent 14 days at one job site during one tax year.

The SBE felt that Aqua Aerobic had failed to meet the burden of proving that its activities were within the limits of PL 86-272, therefore, the public law did not shield the corporation from taxation in California.

CROSS REFERENCE: Chapter 36

TOPICAL INDEX: Nexus

ASARCO (1977)

Montana v. ASARCO, Inc. (1977) - 567 P2d 901.

Montana's tax laws allowed corporations to compute their net income allocable to Montana by use of either an apportionment formula or separate accounting. However, separate accounting could only be used if income from sources within Montana could be segregated from sources without the state. If this condition was not met, business income HAD to be apportioned using the standard 3-factor formula.

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Prior to 1962, ASARCO had filed its Montana returns using separate accounting. In 1962, ASARCO determined that its business activities inside and outside of Montana were unitary in nature and it requested permission from Montana to use an apportionment formula. Permission was granted. Thereafter ASARCO filed its Montana returns using an apportionment formula to properly compute its business income and by allocating the income the company determined to be non-business in nature to sources outside of Montana.

On ASARCO's 1967 - 1970 Montana returns the following income was classified as non-business income:

* Royalty income from the lessees of ASARCO's Keystone Mine in Colorado. The mine was previously operated by ASARCO.

* Royalty income from patents and copyrights on items developed by ASARCO and used in ASARCO's operations.

* Rental income from housing units located on mine properties and rented to ASARCO employees.

* Interest income from short-term investments, customer notes and notes on the sale of a plant and General Cable stock.

* Gains from the sale of tangible property.

* Dividend income.

* Gains on the sale of stock of various companies, including:

** General Cable
** Revere Copper
** Kennicott Copper
** Hecla Mining Company

In audit all of the above income was reclassified as business income and apportioned to Montana. In addition, Montana determined that ASARCO and 6 of its wholly owned subsidiaries were conducting a unitary business and should, therefore, use the combined apportionment method in determining the proper amount of Montana taxable income.

The Montana Supreme Court held in favor of Montana. It found that all of the income listed above was business income in nature and should be apportioned to Montana. The gains on the sale of stock were considered to be business income because,

"These corporations are all engaged in the business of either producing metal ore or manufacturing the refined product into goods. The stock was used by ASARCO for

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business purposes, such as gaining access to raw materials or access to potential customers for its refined metals. Therefore all the...income was generated by the unitary business operation of ASARCO."

The Court further found that ASARCO and its 6 subsidiaries were involved in a unitary business relationship and, as such, should compute the proper Montana income using combined apportionment. The 6 subsidiaries were determined to be unitary due to the following facts:

* Federated Metals of Canada - A Canadian corporation which basically operated the same business in Canada as ASARCO did in the United States. ASARCO provided this company with operations technology, accounting services and financial services. There was also a significant amount of company sales within the company.

* ASARCO Mercantile Company - A corporation engaged solely in the purchase and sale of machinery for ASARCO's subsidiaries. All central services were provided by ASARCO.

* Enthone, Inc. - A Connecticut corporation engaged in the manufacture and sale of metal finishing chemicals and supplies used in metal plating. Enthone purchased about 16% of its raw materials from ASARCO and ASARCO provided all of its central services.

* International Metal Company - This company was ASARCO's exclusive sales outlet for materials delivered to foreign countries. ASARCO provided all of its central services.

* Lone Star Lead Construction Company - A Texas corporation engaged in lining tanks with lead for protection against corrosive contents. The vast majority of its lead was purchased from ASARCO.

* Northern Peru Mining Company - A Peru mining corporation. All of this company's production was sold to ASARCO and refined in ASARCO plants.

In addition, all of the subsidiaries were 100% owned by ASARCO and had common members on their boards of directors. A close relationship existed between ASARCO's business operations and the subsidiaries, in that the subsidiaries all provided ASARCO with material, services or a market for its products.

An official of ASARCO testified that the services that were provided by ASARCO to all of its subsidiaries included:

* Insurance
* Top management
* Legal
* Financial - Any subsidiary that needed capital did not go to outside sources before going to ASARCO first.

CROSS REFERENCE: None

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TOPICAL INDEX: Apportionment/Non-business Income/Unitary

ASARCO (1982)

ASARCO, Incorporated v. Idaho State Tax Commission (1982) - 458 US 307, 73 L ED 2d 787, 102 SCt 3103.

ASARCO was a corporation that mined, smelted and refined nonferrous metals in various states. ASARCO's primary activity in Idaho was the operation of a silver mine however, it also mined some other metals and operated an administrative office for its northwest mining division in that State.

During the years involved ASARCO received three types of intangible income which Idaho sought to include in business income to be apportioned to the State.

* ASARCO received dividends from five corporations in which it owned majority interests:

** M.I.M. Holdings, Ltd. which was engaged in the mining, milling, smelting and refining of nonferrous metals in Australia and England - ASARCO owned 53% of the stock.

** General Cable Corp. which was a fabricator of cables - ASARCO owned 34% of the stock.

** Rever Copper and Brass which was a manufacturer of copper wires - ASARCO owned 34% of the stock.

** ASARCO Mexicana, S.A. was engaged in the same type of business in Mexico as ASARCO did in the United States - ASARCO owned 49% of the stock.

** Southern Peru Copper Corp. mined and smelted copper in Peru - ASARCO owned 51.5% of the stock.

* ASARCO received interest income from three sources:

** Rever Copper and Brass convertible debentures.

** A note received in connection with a prior sale of Mexicana stock.

** A note received in connection with the sale of General Cable stock.

* ASARCO received capital gains from the sale of General Cable stock and M.I.M. stock.

ASARCO had originally filed on a separate apportionment basis and had classified this intangible income as non-business income. Idaho, in audit, determined that the links

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between the companies identified above and ASARCO were insufficient to justify unitizing the companies but that the income received from the companies was business income to ASARCO. Idaho believed that a unitary relationship had to exist between ASARCO and these companies in order for the State to have the right to tax the income however, it felt that corporate PURPOSE should define unitary business for this determination. The intangible income should be considered a part of a unitary business (and, thus, be considered business income) if the related intangible property is "acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business."

The US Supreme Court held that:

"The State of Idaho may not constitutionally include within the taxable income of appellant nondomiciliary parent corporation doing some business (primarily silver mining) in the State, a portion of intangible income (dividends, interest payments, and capital gains from the sale of stock) that appellant received from subsidiary corporations having no other connection with the State.

(a) As a general principle, a state may not tax value earned outside its borders. 'The linchpin of apportionability in the field of state income taxation is the unitary-business principle.' (Mobil Oil Corp. v. Comm. of Taxes of Vermont, 445 US 425, 439; Exxon Corp. v. Wisconsin Dept. of Revenue, 447 US 207, 223.)

(b) Here, based on the findings in the State trial court and the undisputed facts, appellant succeeded in proving that no unitary business relationship existed between appellant and its subsidiaries.

(c) To have, as Idaho proposes, corporate purpose define unitary business - i.e. to consider intangible income as part of a unitary business if the intangible property (shares of stock) is "acquired, managed or disposed of for purposes relating or contributing to the taxpayer's business" - would destroy the concept of unitary business. Such a definition, which would permit nondomiciliary states to apportion and tax dividends 'where the business activities of the dividend payer have nothing to do with the activities of the recipient in the taxing state,' (Mobil Oil Corp. supra, at 442) cannot be accepted consistently with recognized due process standards. While the dividend-paying subsidiaries in this case "add to the riches" of appellant, (Wallace v. Hines, 253 US 66, 70 (1920)), they are "discrete business enterprises" that in "any business or economic sense" have "nothing to do with the activities" of appellant in Idaho. (Mobil Oil Corp. supra, at 439-442) Therefore, there is no "rational relationship between (appellant's dividend) income attributed to the State and the intrastate values of the enterprise." (Mobil Oil Corp. supra, at 437.) The Due Process Clause bars Idaho's effort to levy upon income that which is not properly within the reach of its taxing power.

(d) Under the same unitary-business standard applied to the dividend income in question, Idaho's attempt to tax the interest and capital gains income derived from its subsidiaries also violates the Due Process Clause."

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CROSS REFERENCE: Chapter 28, Chapter 29 and Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment/Non-business Income/Unitary

ATLANTIC RICHFIELD COMPANY (1979)

Atlantic Richfield Company v. The State of Colorado (1979) - 601 P2d 628.

The main issue of the case was whether installment sale interest income and capital gains arising from the sale of assets due to antitrust litigation was business or non-business income.

Atlantic Richfield Company (ARCO) was a large, integrated oil company, commercially domiciled in California. In November 1968, ARCO and Sinclair Oil Company agreed to merge. ARCO's purpose for the merger was to provide it with nationwide diversified operations and greater financial resources. ARCO had participated in several other similar ventures in the past.

As a result of antitrust challenges filed by the US government and resulting judgements, ARCO was forced to sell some of the assets acquired from Sinclair.

ARCO contended that the TRANSACTIONAL TEST should be used to determine whether the income constituted business or non-business income. This test turns on whether the income is derived from a transaction or activity in the regular course of a trade or business. In the transactional test, the frequency and regularity of the activity are crucial factors. ARCO asserted that it was not in the business of buying and selling large blocks of assets pursuant to a court order, therefore, the capital gains and interest income at issue must be classified as non-business income.

Colorado contended that the FUNCTIONAL TEST should be used in the determination. Under this test, gains from the disposition of property are considered business income if the property disposed of was used by the taxpayer in its regular trade or business operations. Under this test, the extraordinary nature or the infrequency of the transaction is irrelevant.

The Colorado Supreme Court held that the income in question was business income because it resulted from a transaction in the regular course of ARCO's business. ARCO had frequently engaged in major acquisitions and dispositions of companies and assets and was aware that some of the assets which were acquired as a result of the Standard merger would have to be sold as a result of the antitrust issue. Therefore, the Court reasoned that although the disposition of assets to meet the requirements of the antitrust laws was infrequent, it was neither unusual nor unforeseeable in the circumstances of the merger two oil companies of such magnitude.

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TOPICAL INDEX: Non-business Income

ATLANTIC RICHFIELD COMPANY (1986)

Atlantic Richfield Company v. Oregon Department of Revenue (1986) - 717 P2d 613.

Atlantic Richfield Company ("ARCO") was a Pennsylvania corporation whose principal office was in California. The company did business in Oregon. In filing its Oregon income tax returns for the tax years 1973 through 1977, ARCO computed its property factor by including all of its intangible drilling costs (IDCs) whether they were expensed or capitalized for federal purposes.

In audit, Oregon recomputed the company's property factor by including only the capitalized IDCs. Oregon relied on its property factor statute which stated that "[p]roperty owned by the taxpayer is valued at its original cost" and on its rules which stated that "[a]s a general rule "original cost" is deemed to be the basis of the property for federal income tax purposes at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial dispositions thereof, by reason of sale, exchange, abandonment, etc." Since the expensed IDCs do not become a part of the "original cost" for federal purposes, Oregon did not include them in the property factor.

ARCO argued that IDCs should be included in the property factor whether or not the federal expensing election was made. The fact that the Oregon regulation stated the above as a "general rule" provided that there were exceptions to the rule. ARCO believed expensed IDCs should be such an exception.

ARCO further argued that since Oregon had incorporated the uniformity clause of the Multistate Tax Compact into its statutes, its rules should strive to provide a uniformity with other states' tax laws. The company pointed to Alaska, an MTC and UDITPA state, which required that IDCs be included in the property factor regardless of their federal treatment. Subsequently, information was obtained that listed three additional MTC and UDITPA states with similar rules.

The Oregon Supreme Court found in favor of ARCO. The Court based its decision on the uniformity argument. Did the exclusion of the expensed IDCs oppose the uniformity clause's "...general purpose; to make uniform the law of those states which enact UDITPA." The Court found that the all (4 states: Alaska, Nebraska, Utah and North Dakota) of the UDITPA jurisdictions which had considered the IDC question, required that IDCs be included in the property factor, regardless of whether they were expensed or capitalized on the federal level.
Therefore,
"...because uniformity is a predicate for UDITPA's success, we believe that we must consider the statutes and rules [of the 4 states]. In the absence of any indication that other UDITPA states apply [the expensed IDC exclusion rule] as did the department and

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Tax Court, and in order to meet the UDITPA "uniformity" criterion, we hold that IDCs should be included in "original cost"."

CROSS REFERENCE: None

TOPICAL INDEX: Property Factor - Intangible Drilling Costs

ATLAS FOUNDRY & MACHINE COMPANY

Atlas Foundry & Machine Company v. Oregon State Tax Commission (1965) - 2 OTR 200.

Atlas Foundry & Machine Company ("Atlas") manufactured and sold special order castings. The manufacturing was performed at its plant in Tacoma, Washington. A small percentage of Atlas' business consisted of manufacturing and selling standard items such as manholes and utility castings. The Oregon Tax Commission believed that Atlas had sufficient activities within the state of Oregon to create nexus for income tax purposes for the period of 1955 through 1961. Atlas argued that its activities in Oregon were within those permitted by PL 86-272 and it was, therefore, immune from income taxation in that state.

An overview of Atlas' business activities follows:

* All of Atlas' orders were accepted in Washington, billed from Washington and payment was received in Washington.

* All of Atlas' orders were filled in Washington and were delivered into Oregon either by common carrier or by Atlas' trucks. Atlas' trucks made about 2 shipments a week into Oregon. The trucks also hauled foundry supplies from a supplier in Oregon on their return trips. All of the foundry purchases were arranged from the Washington location.

* Atlas had one employee salesman who lived in Washington but spent two-thirds of his time in Oregon. His work consisted of promoting goodwill and soliciting sales. The employee had no technical background, did not write orders and could not authorize even minor repairs. At times the employee received customer complaints however he merely sent the information to the Washington office for response. The employee carried no samples.

* Two other employees of Atlas occasionally visited Oregon (about once every six weeks) to visit customers and generally promote goodwill. An inspector and a works manager from Atlas also visited customers in Oregon occasionally to coordinate the inspection department with the wants of the customer and to take care of specific complaints.

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* In 1955 and 1956, Atlas maintained a very small sales office in Oregon. The office space was rented from a warehouse company and the furnishings consisted of a desk, chair and telephone.

The telephone was answered by an employee of the warehouse company. The office was primarily used as place where Atlas' customers could reach the company's salesman. A listing appeared in the Portland, Oregon telephone book for Atlas Foundry & Mach. Co. with the salesman listed as a Portland representative and the sales office's address and telephone number.

* Other than in 1955 and 1956, Atlas owned no property in Oregon and never maintained any inventory in the state. Atlas performed no installation in Oregon.

The Oregon Tax Court found that maintaining a sales office in the state exceed the permitted activities of PL 86-272. Therefore, in 1955 and 1956 Atlas was determined to have nexus in Oregon and be liable for Oregon income tax. For all of the other years involved, the Oregon Tax Court found that Atlas' activities in Oregon did not exceed those permitted by PL 86-272, therefore, Atlas was immune from income taxation for those periods.

CROSS REFERENCE: Chapter 36

TOPICAL INDEX: Nexus

BALLA

Balla v. Illinois Department of Revenue (1981) - 96 Ill App 3d 293.

Diana Balla had originally claimed exemptions for herself and her three children on both her federal and Illinois income tax returns. The IRS notified Ms. Balla that they were reducing her exemptions by three. The Illinois Department of Revenue, based on the IRS action, also reduced the number of exemptions and recomputed Ms. Balla's income tax liability. Ms. Balla argued that the Department had not met their burden of proof to reduce the number of exemptions she had originally claimed.

The Illinois Appellate Court ruled in favor of the Department. When determining the proper amount of taxable income, the burden of proof ordinarily first falls upon the taxing authority. The Illinois legislature, in an effort to aid the Department, provided in Section 904 of the IITA that the findings of the Department are "prima facie" correct. If a taxpayer provides evidence contrary to the Department's position, the Department must present evidence to overcome the taxpayer's contention.

However, if a taxpayer claims to be exempt from taxation or takes advantage of deductions or credits allowed by statute, the burden of proof first falls upon the taxpayer. "This derives from the fact that deductions and exemptions are privileges created by

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statute as a matter of legislative grace. Statutes granting such privileges are to be strictly construed in favor of taxation." Therefore, in this case, the burden first fell upon Ms. Balla to show that she was entitled to the three additional exemptions.

CROSS REFERENCE: None

TOPICAL INDEX: Burden of Proof

BARBER-GREENE COMPANY

Barber-Greene Company, Barber-Green Americas and B-G-S Engineering, Inc. v. Illinois Department of Revenue (1987) - No. MR KA '84 0095 (Cir. Ct. Ill., June 4, 1985), aff'd No. 2-85-0108 (Ct. App. Ill., October 28, 1986), petition denied February 6, 1987 by Illinois Supreme Court.

THE BARBER-GREENE COMPANY CASE IS AN UNPUBLISHED DECISION OF THE ILLINOIS APPELLATE COURT. UNPUBLISHED OPINIONS DO NOT SET PRECEDENT AND CANNOT BE REFERENCED IN ANY OTHER CASE.

Taxpayer argued that it treated its subsidiaries as an investor would treat its investments and, therefore, should NOT be considered part of a unitary business group with its subsidiaries. The Court agreed with taxpayer's assessment of the facts. It stated that there was no evidence in the record to support the Department's conclusion that Barber-Greene exercised strong central management to achieve economies of scale and functional integration or that the interrelationship between companies is such as it would be impossible to determine income in Illinois without treating the group as a unitary business.

Each of the subsidiaries independently decided which products to produce and there were substantial product differences between the parent and each of the subsidiaries. The subsidiaries were responsible for their own engineering, design and manufacture and the parent and each subsidiary had independent design and engineering departments.

Each of the subsidiaries marketed its own products through independent dealers and there was competition for business among the subsidiaries outside their own natural territory. Each subsidiary established its own product warranty policy and each selected its own suppliers, set its own prices and established its own personnel, salary and benefit programs and policies.

Each subsidiary established its own banking and finance relationships independent of the parent and each other. Each subsidiary was responsible for its own legal and accounting support. In short, the parent emphasized decentralization and treated its subsidiaries as discrete business enterprises.

CROSS REFERENCE: Chapter 28

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TOPICAL INDEX: Unitary

BARNES DRILL COMPANY

Barnes Drill Company v. Illinois Department of Revenue. Circuit Court 555 June 24, 1991.

Barnes Drill Company filed a complaint for administrative review from decision of the Illinois Department of Revenue. The issue in this case involves a refund in the amount of $39,504. The Drill Company asserted that they were entitled to this refund for the tax year ended June 30, 1981. The point of contention is whether or not this claim was filed in a timely manner. The Department concluded that the Drill Company did not file the claim in time. They denied the refund based on the preceding information.

The interesting dynamics to this case surround the interpretation of the Illinois Income Tax Act Section 203(e)(2)(E) and Sections 506(b) and 911(b). Initially the Department ruled that Barnes was entitled to the refund, but the Director reversed that decision and held that the taxpayer failed to file its claim for refund within two years and twenty days of the payment of the federal tentative carryback adjustment. He disapproved the recommendation of the Administrative Law Judge and denied the refund for 1981 as not being filed in a timely manner. The Court reversed the decision of the Director of the Department of Revenue. It held that regulation 100.5600 allows two deadlines within which to file claims for refund. Under this regulation the taxpayer has two years and twenty days after the final federal determination of taxable income. The ALJ determined that this date was September 19, 1986. The Court agrees with this particular date. The Court ruled that the claim for refund was filed in a timely manner. They held that the plaintiff was entitled to a refund of $39,504.

CROSS REFERENCE:

TOPICAL INDEX:

BARNES DRILL COMPANY (ON APPEAL)

Barnes Drill Company v. Illinois Department of Revenue Appeal from Circuit Court. First Judicial District. December 17,1992.

The Department of Revenue appealed the decision of the Circuit Court granting a refund for the Barnes Drill Company. The issue in the case was whether or not Barnes Drill Company filed a timely request for a refund. The Department of Revenue contended that the Barnes Drill Company did not file a timely request for a refund for the tax year ending June 30, 1981. The Drill Company argued that under section 100.5600(b) of the Department's regulations, which states that a request for refund must be filed not later than 3 years and twenty days after the last day of the taxable year in which the loss

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occurred which generated the pro forma (federal) change, or two years and 20 days from the date the amount of loss...is finally determined for federal purposes.

The controversy that existed in this case surrounded the stipulation of the designated date of final determination of a loss for federal income tax purposes. The Drill Company asserted that the "final federal determination" occurred on the date that the Joint Committee on Taxation approved the grant of the request for a temporary loss carryback adjustment to Barnes and its affiliates. The Court of Appeals agreed with that assertion.

The Court noted that because the Joint Committee had to review and approve the issuance of the check, the temporary loss carryback adjustment was not "final" until such approval by the Joint Committee.

The Court held that for purposes of the running of the applicable limitation period for Barnes' request for Illinois Income tax refund...the adjustment was not final until the Joint Committee issued its report approving the adjustment. The report was issued in September 1986, and the Drill Company's request for a refund fell within the two year/twenty day time limit of regulation section 100.5600(b). The Court of Appeals affirmed the decision of the Circuit Court and the Barnes Drill Company was entitled to receive a refund.

CROSS REFERENCE:

TOPICAL INDEX:

BASS, RATCLIFF, & GRETTON, LTD.

Bass, Ratcliff, & Gretton, Ltd. v. New York State Tax Commission (1924) - 266 US 271.

Bass, Ratcliff, & Gretton, Ltd. ("Bass") contended that the tax New York sought to impose was not based upon net income derived from activities within New York but, rather, was based upon business activities occurring outside of New York and the United States as a whole. Therefore, Bass believed the imposition of the tax was in violation of the Due Process Clause and, by imposing a direct burden upon its foreign commerce, the Commerce Clause.

The US Supreme Court held that Bass carried on a unitary business involving the manufacture and sale of ale, in which the profits were earned by a series of transactions beginning with the manufacture in England and ending with the sales in New York and other states. The manufacturing process resulted in no profits until it ended in sales. Therefore, the Court held that New York was justified in attributing to the State a portion of the profits earned from the entire unitary business.

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This case was similar to the UNDERWOOD TYPEWRITER case except that Bass included foreign income. Also, it was the first time the term "unitary business" was used, however, the Court did not define the term.

CROSS REFERENCE: Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment/Unitary

BEATRICE COMPANIES, INC.

Beatrice Companies Inc. v. Illinois Department of Revenue. Circuit Court- Cook County, February 23, 1996.

The issues in this case were controlled by the First Appellate Court decision in Dover Corporation v. Department of Revenue. The Circuit Court held that the decision of the Department of Revenue was affirmed.

CROSS REFERENCE:

TOPICAL INDEX:

BELL FEDERAL SAVINGS AND LOAN

Bell Federal Savings and Loan Association v. Illinois Department of Revenue (1982) - 111 Ill App 3d 890.

Bell Federal Savings and Loan Association ("Bell") claimed that Federal law prohibited Illinois from taxing certain funds which Bell received from the Federal Home Loan Savings Bank of Chicago ("FHLB") and the Federal Savings and Loan Insurance Corporation ("FSLIC"). The Illinois Department of Revenue disagreed and the Illinois Appellate Court found in favor of the Department of Revenue.

FHLB DIVIDENDS

Bell argued that the dividends it received on its FHLB stock should be exempt from state taxation under Section 1433 of Title 12 of the United States Code. Section 1433 provides that except for real estate taxes, each regional Federal Home Loan Bank, "including its franchise, its capital, reserves, and surplus, its advances, and its income, shall be exempt from all taxation now or hereafter imposed by...any State..." Bell argued that imposing a State tax on the dividends received on FHLB stock would "impermissibly interfere" with FHLB activities, which are exempt.

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Secondly Bell argued that the dividends which the FHLB paid to its stockholders were actually "income" or "surplus" of the FHLB and, therefore, was expressly immune from State taxation under Section 1433.

The Appellate Court found that, at best, there might be a remote economic relationship between the FHLB activities and FHLB stock however there was no support for concluding that FHLB dividends were an indispensable or integral part of the exempt FHLB loan process. Therefore, the Court found that the dividends received on FHLB stock were not immune from State taxation by virtue of federal statutes.

Further the Appellate Court found that once the income was passed from the FHLB to the stockholders, it was no longer income of the FHLB. It found nothing to indicate that Congress intended the FHLB exemption from State taxation to flow through to the shareholders. "...section 1433 exempts the income and surplus of the FHLB, not the income and surplus of savings and loan associations."

INCOME RECEIVED FROM THE FSLIC

Bell argued that the income which Bell received as a refund of Bell's pro rata share of the Federal Savings and Loan Insurance Corporation "secondary reserve" was exempt from state taxation by virtue of Section 1725 of Title 12 of the United States Code. Section 1723 provides that all states are prohibited from taxing the principal and interest of "[a]ll notes, bonds, debentures, or other such obligations issued by the [Federal Savings and Loan Insurance Corporation]."

The FSLIC insured the accounts of federal savings and loan associations. The institutions were charged annual premiums and, at one time, were also required to make contributions to the FLSIC "secondary reserve". Beginning in 1973, the FSLIC was required to make yearly refunds to the institutions of their pro rata share of the secondary reserve. Bell contended that refunds which the FSLIC were required to make were "obligations issued by the FSLIC and were, therefore, exempt from State taxation.

Bell also argued that the refunds received were exempt from State taxation by the portion of Section 1725(e) which exempts the FSLIC itself from State taxation, "including its franchise, capital, reserves, surplus, and income."

The Appellate Court again found in favor of Illinois stating that while the FSLIC's requirement to refund the money could be thought of as an "obligation" of the FSLIC in a very general sense, it could not be considered an "obligation issued" by the FSLIC. Therefore, the refunds were not exempt from taxation by Illinois.

Secondly, the Appellate Court rejected Bell's contention that the refunds were actually "capital, reserves, surplus, and income" of the FSLIC. Again, once title to the funds passed to the savings and loan associations, the money was no longer covered by the exemption for funds belonging to the FSLIC.

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CROSS REFERENCE: None

TOPICAL INDEX US Interest - FHLB Dividends/US Interest - FSLIC Refunds

BERNARD BEREBHOLTZ

Bernard Berenholtz v. U.S. , U.S. Court of Appeals, Federal Circuit; 2/19/86

Bernard Berenholtz filed a suit requesting a refund of federal income taxes. He sought to recover income taxes in the amounts of $7,093, $24,044, and $25,066, plus interest for the taxable years 1975, 1976 and 1977, respectively. Berenholtz borrowed money from the First National Bank in Princeton to establish a book publishing company, and he sent tax-exempt bonds to the bank for collateral. Berenholtz paid interest on the loans in each of the years 1971 through 1977, and he deducted the interest on his federal income tax return each year. The IRS examined his financial records for the years 1975, 1976, and 1977. They concluded that his interest deductions were not legitimate under the Internal Revenue Code section 265(2).

The issues were:

1. The issue surrounded Berenholtz's claim that he was entitled to a refund for the three years that were in question. Berenholtz claimed interest deductions for the taxable years 1971-1977. The Internal Revenue Service concluded that his Pyne Press indebtedness was indebtedness incurred or continued to purchase or carry Berenholtz' tax exempt bonds, within the meaning of Section 265(2), which provides that no deduction shall be allowed for interest on such indebtedness. In addition to the IRS disallowing the interest deductions, they also disallowed certain deductions for investment and custodial fees claimed by Berenholtz on his 1975, 1976, and 1977, respectively.

2. Berenholtz claimed that he did not use his tax exempt bonds as collateral for the loans. He stated that is other assets were sufficient enough to cover his loans, but no evidence he presented supported this claim. The government was barred by the statute of limitations from making any deficiency assessment against Berenholtz for the years 1971-1974, but they could make upward adjustment to his income for the years that were in question (1975-1977). The adjustment resulted in an increase in Berenholtz' tax liability for 1975, 1976, and 1977. This was a point of contention in the eyes of Berenholtz, but the adjustment was supported under the law. The Court of Appeals affirmed the judgement of the Claims Court and Berenholtz was not entitled to a tax refund for the three years at issue.

CROSS REFERENCE:

TOPICAL INDEX:

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BODINE ELECTRIC COMPANY

Bodine Electric Company v. Robert H. Allphin (1980) – 81 Ill 2d 502.

Bodine filed Illinois claims for refund carrying back a net operating loss (NOL) incurred in the year ended 12/31/71 to years ending 12/31/69 and 12/31/70 . For Federal purposes, the NOL was carried back to the year ending 12/31/68 and was entirely absorbed in that year.

Taxpayer contended that for Illinois purposes, the loss should be carried back to 12/31/69 and 12/31/70 since these were the earliest ILLINOIS years available to absorb the NOL carryback. Requiring the NOL to be carried back to 12/31/68 would, in their opinion, result in a retroactive application of the IITA.

The Illinois Supreme Court ruled that the legislative intent of the Illinois Income Tax Act (IITA) was to require taxpayers to carry back their net operating losses to the same years and in the same amount as on their federal income tax returns. The Court did not agree that this would result in a retroactive application of the IITA.

This court case is often used as a basis for not allowing deductions from federal taxable income that are not specifically provided by statute.

CROSS REFERENCE: Chapter 41

TOPICAL INDEX: Net Operating Losses

BORDEN, INC.

Appeal of Borden, Inc., California SBE (1977) - CCH California State Income Tax Reporter [1971 - 1978 Transfer Binder], Para. 205-616.

Borden, a multistate corporation, sold its entire California division and realized a capital loss which it claimed as non-business income. The entire capital loss was allocated to California. The sales contract specifically allocated a portion of the purchase price to goodwill.

California regulations define "business income" as income arising from transactions in tangible or intangible property if the acquisition, management, and disposition of the property are integral parts of the taxpayer's regular trade or business. The California regulation also states that gain or loss from the sale of tangible or intangible property is "business income" if the property, while owned by the taxpayer, was used to produce business income.

The SBE ruled that the entire capital loss was "business income" and must be apportioned among the states in which the taxpayer did business. Under the functional test, all income

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from property is considered business income if the acquisition, management, and disposition of the property are integral parts of the taxpayer's regular business operations, regardless of whether the income was derived from an occasional or extraordinary transaction. The SBE also stated that the capital loss on the sale of goodwill should be treated as "business income" regardless of the fact that the taxpayer did not claim depreciation or any other deductions on it. The SBE concluded that it was undeniable that the goodwill contributed materially to the taxpayer's business as a whole.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Non-business Income

BOREN

Boren v. Tucker, (1956, CA9) - 239 F2d 767, 50 AFTR 1217, 57-1 USTC.

During an investigation of the income tax liability of Clifford and Delta Boren, the IRS issued an administrative subpoena requiring the production of records. When they refused to comply with the subpoena, the IRS filed a petition with the court seeking to enforce the subpoena.

The Court of Appeals ordered them to produce for examination, copying, Photostatting or photographing the documents requested in the subpoena. The Court's ruling established that the right of the IRS to examine a taxpayer's records included the right to make photostatic copies where necessary.

CROSS REFERENCE: Chapter 27 and Chapter 35 - Subpoenas

TOPICAL INDEX: Photocopying information/Subpoena

BUFFETS, INC.

Buffets, Inc. v. Department of Revenue. Administrative Hearings. - 12/12/94

Buffets Inc., a corporation engaged in the restaurant business operating in approximately 16 States, filed an objection to the partial denial of replacement tax investment credits. They are also objecting to the penalty imposed by the Department for failure to pay tax pursuant to 35 ILCS 5/1005. Buffets Inc. were seeking to include certain items of tangible personal property that were deemed to be questionable under the replacement tax investment credit divisions of the Illinois Income Tax Act. They were also petitioning the Department to waive their tax liability, based on the notion that their failure to pay their Income Tax liability in a timely fashion, was due to a reasonable cause.

The issues were:

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1. The taxpayer was a corporation operating in several states. They desired to include such items as; wet and dry vacuum cleaners, bathrooms, security cameras, telephones and answering machines, employee training and time management systems, computer hardware and software, and employee travel expenses to assist in new store set- up in the category of personal property used in their operations. The Department auditor recommended the denial of the replacement tax investment credit for the property in question because he determined that such property was not used exclusively for retailing.

2. The issue concerning which tangible property is to be included in the calculation of the Personal Property income Tax Credit was resolved using the statute that defines the parameters of what can be included in the calculation of this credit (35 ILCS 5/201 (e)). The credit rate is equal to .5% and the property that qualifies for the credit is defined as; property that is new or used, tangible, depreciable, purchased, not previously used in Illinois for the credit....used in manufacturing, mining, or retailing. The Buffets Corporation claimed that their items were used in the retailing of their business. The auditor determined that the property in question failed to qualify for the replacement tax investment credit because the property was not used exclusively in retailing. The Buffets Corporation waived their right to a hearing and the Administrative Law Judge ruled in favor of the Department of Revenue. He stated that the Corporation did not present any admissible evidence to support their claims of being qualified to receive tax credit on the items that were in question. It was recommended that the Director of Revenue issue a Notice of Decision upholding the Notice of Deficiency in its entirety.

CROSS REFERENCE:

TOPICAL INDEX:

BUTLER BROTHERS

Butler Brothers v. McColgan (CA) (1942) - 315 US 501, 62 SCt 701.

Butler Brothers was an Illinois corporation with its corporate headquarters located in Chicago, Illinois. The company was engaged in the wholesale dry goods and general merchandise business by purchasing from manufacturers and selling only to retailers. The company operated wholesale distributing houses in Chicago, Jersey City, Baltimore, Minneapolis, St. Louis, Dallas, and San Francisco.

Each of the houses served a separate trade territory. Each house maintained its own inventory from which sales were made in its territory. Each house handled its own sales, solicitation, credit and collection activities, and kept books and records showing the operations of the house. All of the California sales were made from the San Francisco house.

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A portion of the operating expenses such as labor, rentals, etc. was incurred exclusively by each of the houses. The remainder of the expenses consisted of common expenses of the corporation such as executive salaries, corporate overhead, and the expenses of operating central advertising and purchasing divisions. The expenses of the advertising and purchasing divisions were allocated to the houses based upon generally accepted accounting principals.

The centralized purchasing division purchased goods for resale which were then shipped by the manufacturer to each house. Because of the large volume of purchases, the centralized purchasing division was able to obtain significant discounts on their purchases. These discounts would not have been realized if each of the individual houses had made their own purchases.

In filing its California Income Tax return, the corporation used separate accounting to compute the taxable income from the operations of the San Francisco house. After calculating the gross profit for the San Francisco house, they deducted the direct expenses for the San Francisco house and an apportioned share of common expenses such as executive salaries, corporate overhead, and the expenses of operating the central advertising and purchasing divisions. The California FTB used formulary apportionment to compute taxable income and assessed an additional tax liability against the corporation.

The issue to be resolved in this case was whether or not it was proper for the California FTB to use formulary apportionment or whether it was proper for Butler Brothers to use separate accounting. Butler Brothers claimed that by using formulary apportionment, California was attempting to tax it on income derived from sources beyond the jurisdiction of the state. The California FTB contended that the tax was levied upon income derived from business activities within California, that the operations of the corporation were unitary, and that the use of formulary apportionment was lawful and proper.

If the business within the state was truly separate from the business without the state, so that the segregation of income could be made clearly and accurately, the separate accounting method would be proper. However, where interstate operations were carried on and the business done within the state could not be separated from that done outside the state, the business would be unitary and formulary apportionment should be used to apportion income.

The US Supreme Court determined that where centralized purchasing and other services are performed for all branches in several states, it is impossible to support the proposition that the California operations did not contribute to the advantages of the taxpayer's unitary business, even though each branch operated independently.

In summary, the three tests of unity established in the Butler Brothers case were:

* Unity of ownership.

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* Unity of operation - as evidenced by central purchasing, advertising, accounting and management divisions.

* Unity of use in its centralized executive force and general system of operation.

CROSS REFERENCE: Chapters 28 and 35 - Apportionment

TOPICAL INDEX: Apportionment/Unitary

CATERPILLAR FINANCIAL SERVICES CORP

Caterpillar Financial Services Corp (Cat) filed its 1987 corporate return as part of the combined unitary group of the 13 other domestic subs of Caterpillar, Inc. State income tax as filed was calculated using the normal three-factor formula.

The issues were:

1. Should Cat be allowed to exclude from base income the Subpart F dividends it received from foreign subsidiaries?

Presently the IITA does not allow a subtraction for dividends received under Subpart F for years prior to 12/31/88.

2. Should Cat be allowed to use an alternative to the standard three-factor formula with respect to royalties and interest received from the foreign subsidiaries?

Cat had argued that the property, payroll or sales that generated the royalty is not included the factors of any domestic company in the group. Therefore the amount that gets apportioned to Illinois is distorted.

The court ruled that:
1. Subpart F dividends can be deducted from Illinois base income for 1987. The court determined that since the Subpart F income is treated as dividends for federal purposes, they should also be treated as dividends for state purposes.

2. No factor relief was allowed for interest and royalty income. The interest and royalties represent costs to the foreign subsidiaries and are not a part of federal taxable income. Since the apportionment formula is intended to "represent the economic factors that generate taxable income", there was no basis for factor relief.

CROSS REFERENCE:

TOPICAL INDEX

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CATERPILLAR TRACTOR CO. (1979)

Caterpillar Tractor Co. v. Lenckos (1979) - 32 IllDec786, 77 Ill App 3d 90, affirmed 49 IllDec329, 84 Ill 2d 102, appeal dismissed 103 SCt 3562.

Caterpillar and its subsidiaries originally filed separate apportionment Illinois returns for 1969 through 1974. Each of the returns were filed reflecting subtraction modifications for foreign taxes paid (which were taken as credits on the federal return), Section 78 gross-up and Subpart F income. Each of the companies then filed claims for 1970 through 1974 reporting income using the worldwide unitary apportionment method and a claim for 1969 reflecting additional subtraction modifications for foreign source income.

Caterpillar argued that the unitary method of apportionment was authorized under Section 304(a) of the Illinois Income Tax Act (IITA). Caterpillar introduced extensive evidence showing a strong integrated relationship between the parent and its worldwide subsidiaries and also argued that strict policies were enforced to maintain worldwide uniformity in all phases of their operations including production, marketing and employer-employee relationships under central control of the parent corporation. The basis for excluding 1969 was the contention that the unitary method did not accurately reflect the amount of taxable income for that year since the Illinois Income Tax Act did not take effect until August of 1969.

The Department originally denied the claims but, in Administrative Hearing, the claims were allowed under Section 304(f) of the IITA. The Director also determined that the income tax liabilities for 1969 should be computed using the worldwide unitary apportionment method and denied the deductions taken for foreign taxes paid, dividend income and Subpart F income.

Caterpillar took the case to court. In 1979, the Appellate Court decided that the 1969 return liability should be determined using the worldwide unitary method. However, the Department had attempted to utilize the unitary apportionment method in 1969 to recompute Caterpillar's returns and declare a deficiency even though the original return was beyond the general 3-year statute of limitations. The Appellate Court stated that based on LEWIS V. REYNOLDS, "payments already received may be retained to the extent those funds do not exceed the amount which might have properly been assessed and demanded". Therefore, the Department could only use the unitary apportionment method to REDUCE Caterpillar's claim for refund in the 1969 year to zero. It could NOT be used to propose a deficiency for the year.

This led to an "Action on Decision" by the Department that stated, "the Department unqualifiedly adopts the court's holding that notice of deficiency based upon unreported federal changes may not raise new or additional issues previously barred by the general three-year limitations statute."

The Appellate Court also decided that Caterpillar could not take subtraction modifications not specifically allowed in the Illinois Income Tax Act. The fact that the Illinois General

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Assembly had subsequently created a deduction for one of the items (Section 78 Gross-up) by statutory amendment created the presumption that it was intended to change the former law and therefore, "it becomes clear that the former law did not provide for such a deduction, even implicitly."

The portions of the Appellate Court's decision involving the unitary apportionment method and the ability to deduct foreign taxes paid were appealed to the Illinois Supreme Court (See CATERPILLAR (1981)). The portions of the decision regarding the ability to deduct Section 78 Gross-up and Subpart F income were not appealed to the Illinois Supreme Court. Therefore, on these issues, the Appellate Court decision stands.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Section 78 Gross-Up/Subpart F Income

CATERPILLAR TRACTOR CO. (1981)

Caterpillar Tractor Co., et al, v. Daniel Lenckos (1981) - 84 Ill 2d 102.

Ultimately, the Illinois Supreme Court found that the unitary method of apportionment was allowable in Illinois for all years. The Court also found that Caterpillar was not allowed to deduct foreign taxes paid which were claimed as credit on their federal tax return. The taxpayer elected to take the tax credit on their federal return and that election is binding. In addition, the IITA contained no modification for any type of foreign taxes paid until the Section 78 Gross-up subtraction came into effect in 1975.

REFERENCE: Chapter 28, Chapter 29 and Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment/Foreign Taxes Paid/Unitary

CATERPILLAR TRACTOR COMPANY (1987)

Caterpillar Tractor Company v. J. Thomas Johnson (1987) - 117 Ill 2d 454, 512 NE2d 1240.

Refer to Para. 37.5.88 for the Searle Pharmaceuticals, Inc. v. Illinois Department of Revenue synopsis. These two cases were consolidated on appeal.

CROSS REFERENCE: Chapter 33

TOPICAL INDEX: Net Operating Losses/Statute of Limitations

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CHASE BRASS & COPPER COMPANY

Chase Brass & Copper Co. v. FTB (1970) - 10 Cal App 3d 496, 87 Cal Rptr 239.

Chase Brass & Copper Company (Chase) was a wholly owned subsidiary of Kennecott Copper Corp. (Kennecott) which had its corporate headquarters in New York. Kennecott mined, smelted and refined copper, gold, silver, and molybdenite and was the largest producer of copper in the United States.

The issue in this case was whether or not Chase was engaged in a unitary business with Kennecott or any of its subsidiaries.

A brief description of the business operations of Kennecott and its wholly owned subsidiaries follows:

* Kennecott Copper Co. was engaged in the business of mining, smelting, and refining copper, gold, silver, and molybdenite. Kennecott had no business operations in California.

* Braden Copper (Braden) operated mines in Chile. Ordinarily, it sold copper to the government of Chile and other purchasers in the world market. During the years being audited, it made some sales through Kennecott Sales Corp. in the United States because of shortages in this country.

* Chase manufactured brass, bronze and copper rod, sheet, wire and tube. Approximately 80% of the copper purchased by Chase was from either Kennecott or Braden. Chase did not manufacture any products in California but did have a warehouse located in California that stored and sold products for itself and Kennecott Wire & Cable Co.

* Kennecott Sales Corp. (Kennecott Sales) performed all of the activities associated with the sale of copper in the United States for Kennecott and Braden. Kennecott Sales charged Kennecott a commission on all sales made.

* Bear Creek Mining explored for metals in California.

* Kennecott Wire & Cable Co. (Kennecott Wire) manufactured copper rod, wire, and cable for transmission of electricity. It used refined primary copper, all of which it purchased from Kennecott or Braden through Kennecott Sales.

The case was decided based upon the unitary principals established in the Butler Brothers case. A business is considered unitary if these circumstances are met:

* Unity of ownership,

* Unity of operation as evidenced by central purchasing, advertising, accounting and management divisions, and

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* Unity of use of its centralized executive force and general system of operations.

The unity of ownership test was met since all of the corporations were 100%- owned subsidiaries of Kennecott.

Although there is not a clear distinction between what is "unity of operation" and what is "unity of use", the court stated that, in general, the acts falling within the category of "unity of operation" are staff functions, and those within "unity of use" are line functions.

UNITY OF OPERATION

The staff functions of a vertically integrated enterprise probably are not so markedly unitary as they are in a horizontally integrated business. In the case of horizontal integration, functions such as centralized control of advertising of the same product, centralized purchasing, etc. are designed to give advantages to the business - despite geographic differences. In the case of vertical integration involving various steps in the production and distribution of a product, integration of staff functions probably will be considerably less.

The following staff functions were examined by the court to determine the extent of the unity of operations:

* Purchasing- Chase had its own purchasing department. Kennecott did some minor purchasing (other than copper) for Chase.

* Advertising- Chase maintained its own advertising program and budget. Chase's name and trademark were predominantly displayed in their advertisements but they often stated that they were a subsidiary of Kennecott. Both Chase and Kennecott used the same advertising agency.

* Accounting- Chase and Kennecott had their own accounting departments but used the same accounting firm.

* Legal- Chase had its own legal staff and usually hired its own outside attorneys. However, Chase's protest to the California Franchise Tax Board was handled by Kennecott's legal department.

* Financing- Chase borrowed $10,000,000 at the prime rate from Kennecott to rehabilitate a manufacturing plant in Waterbury, Connecticut that was severely damaged by flood.

The court considered this to be a substantial indication of unity of operation. The court reasoned that Chase may have been able to borrow the money from a financial institution but the fact remains that it was able to turn readily to its parent for help.

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* Retirement plans- There was a common retirement plan for employees of Chase and Kennecott. The retirement plan was administered by Kennecott.

UNITY OF USE

The following line functions were examined by the court to determine the extent of the unity of use:

* Chase had the assistance and direction of the executives of Kennecott.

The court felt that such an integration of executive forces was an extremely important indication of unity of use.

* The Board of Directors of Kennecott devoted the majority of its time to the problems facing the copper industry in general, including the development and maintenance of its fabricating subsidiaries.

* The executives of the subsidiaries reported to the president of Kennecott with respect to major policy matters.

The court considered the control of major policy matters to be a significant indication of unity of use. The court did not place much emphasis on the fact that the subsidiaries controlled their own day to day operations.

* Kennecott reviewed the executive salaries for Chase.

* Kennecott sold about 20% of its total copper production to Chase through Kennecott Sales. Kennecott sold to Chase at exactly the same price as that which it charged Chase's competitors.

The court then looked at the relationship between Chase and Kennecott Wire. Chase had taken over the sales of a major part of the products sold by Kennecott Wire. Chase warehoused the products of Kennecott Wire and Chase's salesmen called on prospective wire and copper customers. If Chase's salesmen obtained orders, they sent them to Kennecott Wire. The orders were filled and shipped in the name of Chase. Chase received a discount on the products sold.

The court ruled that a unitary relationship was present between Kennecott, Kennecott Sales, and Chase due to the Kennecott's control of major policy decisions and the amount of intercompany sales. The court also ruled that although the products were different (although they were all, to some extent, composed of copper), the activities clearly showed that a unitary relationship existed between Chase and Kennecott Wire. The court concluded that Braden and Bear Creek should not be included in the unitary group.

Finally, the court decided that Kennecott's sales of gold, silver, and molybdenite, which were not bought by Chase or Kennecott Wire, were not part of the unitary business. The

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fact that these metals come from the same ore as that which produces copper was not sufficient to cause this activity to be a part of the unitary business.

CROSS REFERENCE: Chapter 28 and Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment/Unitary

CHEN

Chen et al. v. Illinois Department of Revenue (1990) - 145 Ill App 3d 520, 495 NE2d 1124.

Monroe-Franklin Properties was a partnership that, during the year ending 12/31/83, conducted business in Illinois and filed an IL-1065.

During 1971, the partnership acquired a building at 230 W. Monroe St. in Chicago, Illinois. On July 1, 1979, the building was valued at $36,700,000 and the partnership's basis in the building for federal income tax purposes was $12,627,926. The value of the building exceeded the partnership's basis by $24,072,074 on July 1, 1979. The partnership sold the building in September, 1983.

The partnership reported Unmodified Base Income of $30,955,821 on its IL-1065 return for the year ending 12/31/83. The partnership claimed a valuation limitation deduction of $24,072,074 on the return. The partnership clearly stated on the IL-1065 return that the valuation limitation deduction had been calculated from July 1, 1979 rather than August 1, 1969 which was the date required by the return.

The Department determined that the partnership had improperly reduced its base income by calculating the valuation limitation deduction from July 1, 1979 instead of August 1, 1969. The Department disallowed the valuation limitation deduction and issued the partnership a non-protestable, MATH ERROR notice. The Department assessed a Replacement Tax deficiency of $361,081 against the partnership.

The partnership paid the deficiency and on the same day filed a claim for refund with the Department. The Department subsequently notified the partnership that their claim for refund had been denied based on the position that the valuation limitation deduction should have been calculated from August 1, 1969, instead of July 1, 1979, the date used by the partnership. The issue was ultimately decided by the Illinois Appellate Court.

Prior to July 1, 1979, a partnership's net income had been treated as income of the partners and was subject to Illinois Income Tax at ONLY the partner level. The Illinois Partnership Return (IL-1065) was strictly an information return. However, for tax years ending on or after July 1, 1979, PA 81-1stSS-1 amended the IITA to create the Personal Property Tax Replacement Tax ("Replacement Tax"). The Replacement Tax is based

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upon the Illinois net income earned by corporations, trusts, estates, AND PARTNERSHIPS.

PA 81-1stSS-1 also created numerous addition and subtraction modifications for partnerships. Sec. 203(d)(2)(E) allowed a partnership to claim a subtraction modification for the valuation limitation amount. Sections 203(a)(2)(G) and 203(c)(2)(I) of the IITA had allowed the same subtraction modification for individuals, trusts and estates since 1970. The valuation limitation amount is defined in Sec. 203(f) of the IITA.

In general, the valuation limitation amount is equal to:

* The sum of the pre-August 1, 1969 appreciation amounts (consisting of gains reportable under the provisions of Sections 1245 and 1250 of the IRC) for all property on which these gains were reported, plus

* The lessor of:

** The sum of the pre-August 1, 1969 appreciation amounts (consisting of capital gains) for all property on which capital gains were reported for federal income tax purposes, or

** The net capital gain for the taxable year.

Sec. 203(f) was passed by the General Assembly in 1971 and was not amended in 1979 to provide a valuation date for Sec. 203(d)(2)(E) dealing with partnerships. Consequently, the partnership argued that the valuation date for partnerships under the replacement tax should be July 1, 1979 (the date the Replacement Tax became effective). The partnership also argued that the Department was applying the IITA retroactively instead or prospectively. Since, when enacting the Replacement Tax, the General Assembly did not specify a date from which to measure the valuation limitation deduction for partnerships, and since the August 1, 1969 date was retrospective, the partnership concluded that the Department should have used the July 1, 1979 date.

The Department argued that in 1979 since the General Assembly did not amend Sec. 203(f) to make reference to the newly created Sec. 203(d)(2)(E) which dealt with partnerships, they intended to allow a valuation limitation deduction for partnership which was consistent with that provided to individuals, trusts and estates. Finally, the Department noted that the General Assembly amended Section 203(f) on September 18, 1986, to include a reference to the partnership subtraction modification but did not create any special provisions for partnerships in the computation of the subtraction modification.

The Illinois Appellate Court ruled that the valuation limitation deduction provided for partnerships in Sec. 203(d)(2)(E) should be calculated from August 1, 1969 instead of July 1, 1979. The Court did not feel that the use of the August 1, 1969 date resulted in a retroactive application of the IITA. The court reasoned that a tax measured by income is a tax upon realized gains. The fact that a portion of the gain is attributable to increases in value of income-producing items prior to the effective date of an amendment to the IITA,

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or may be attributable to something done prior to such date, does not render the statute retroactive so long as the gain is not realized until after such date.

CROSS REFERENCE: Chapter 34

TOPICAL INDEX: Valuation Limitation Subtraction/Partnerships

CHICAGO TITLE AND TRUST

Chicago Title and Trust Co. v. Illinois Department of Revenue (1986) - 100 Ill Dec 502, 146 Ill App 3d 923.

Chicago Title and Trust incurred federal net operating losses from 1971 through 1976. The company filed its Illinois tax returns starting with Line 30 of its federal return for each year. The negative amounts reported on Line 1 of its Illinois returns involved both current year losses and federal loss carryforwards. The Department adjusted the returns based on its "Line 1 cannot be less than zero" position for years ending prior to December 1, 1983.

The Illinois Appellate Court found that the Department had no authority for limiting Illinois Line 1 to zero. If "federal taxable income" was actually a federal loss or if that federal loss were carried into another year, that negative number should be allowed as a starting point for Illinois tax computations as long as no double deduction of the loss occurred since double deductions were expressly prohibited by the IITA.

CROSS REFERENCE: Chapter 29 and Chapter 41

TOPICAL INDEX: Federal Taxable Income/Net Operating Losses

CITIZENS STATE BANK OF MOUNT MORRIS

Citizens State Bank of Mount Morris v. J. Thomas Johnson (1985) - 130 Ill App 3d 925.

Citizens State Bank of Mount Morris ("Citizens") claimed a US interest deduction on its 1979 and 1980 Illinois income tax returns for interest income received on Ginnie Maes. Citizens relied on Information Bulletin ITIB 1973-1 which listed GNMA participation certificates were an obligation of the US governments and, therefore, were exempt from state taxation by virtue of federal statutes.

In audit, the Illinois Department of Revenue disallowed the deduction claiming that Ginnie Maes were not US obligations and relying on Information Bulletin ITIB 1981-2 which had been published after Citizens' original returns for 1979 and 1980 were filed.

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Citizens argued that the Department was bound by ITIB 1973-1 until ITIB 1981-2 was issued and could not retroactively apply the positions taken in ITIB 1981-2.

The Illinois Appellate Court found in favor of the Department of Revenue. The Court relied on two previous Illinois Appellate Court decisions in the cases of Montgomery Ward Life Insurance Company v. the Department of Local Government Affairs and Rockford Life Insurance Company v. the Department of Revenue. In each of these cases it was decided that Ginnie Maes were not obligations of the United States government and that the prior publication of regulations, manuals, etc. which erroneously listed non-exempt obligations as being exempt obligations did not cause the obligations to become "exempt".

CROSS REFERENCE: None

TOPICAL INDEX: US Interest - GNMA/FNMA

CITIZENS UTILITIES COMPANY OF ILLINOIS

Citizens Utilities Company of Illinois v. Illinois Department of Revenue (1986) - 111 Ill 2d 32.

Citizens Utilities Company of Illinois ("Citizens") filed Illinois returns for 1978 through 1981 using separate apportionment. Since Citizens was a 100% Illinois corporation, this method of filing equated to separate accounting. In audit it was determined that Citizens was a member of a unitary group of companies and was required to apportion its income to Illinois using the unitary apportionment method.

Citizens argued that:

* The unitary apportionment method should not apply to such highly regulated companies as public utilities. Citizens believed that separate accounting accurately reflected the activities of each utility company of the affiliated group.

* They had relied on ITIB 1975-1, which stated that unitary apportionment was no longer permitted in Illinois, to compute its Illinois liabilities and, therefore, did not seek rate increases from the ICC like they would have done if they known they had to file unitary returns.

* Even if unitary was allowable in Illinois, it was not unitary with the other members of its affiliated group.

* Unitary apportionment caused a distorted amount of income to be apportioned to Illinois.

The Illinois Supreme Court, on direct appeal from the Circuit Court of Cook County, found that:

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* The IITA contained no provision to allow utility companies to compute their Illinois tax liabilities using essentially separate accounting. In fact, the IITA contained special apportionment formulas for other highly regulated companies such as financial organizations, insurance companies and transportation companies, therefore, it intended all companies to apportion unless distortion occurred.

* Citizens could not have relied on ITIB 1975-1 because ITIB 1975-2 which was issued 8 days later stated that repeal of the Compact provisions had no substantive effect on apportionment or allocation provisions of the IITA. Also, since Citizens was arguing that it was not unitary even if unitary is allowable in Illinois, it would not have filed unitary returns even if they believed it to be allowable/required in Illinois.

* The manifest weight of the evidence supported the Hearing Officers decision that Citizens was a member of a unitary group:

** The companies had the same officers and interlocking Board of Directors.

** Specific approval of the parent was necessary for all purchases exceeding $500.

** The parent reviewed all major engineering projects and provided legal assistance and complex accounting functions including preparation of tax returns for the subsidiaries at cost.

** The parent was able to "borrow" money from the subsidiaries at the parent's discretion by debiting the subsidiary's intercompany account. The money was "borrowed" interest-free. This was considered to be a very important unitary tie.

The Court felt that the evidence supported the Hearing Officer's decision that a flow of value existed between the companies that resulted in an economy of scale.

* Citizens did not prove that the unitary apportionment method produced a distorted result even though the unitary method of apportionment increased Citizens' tax liability by 213% over that computed using separate accounting. The Court felt that the 213% difference could just as easily be due to the distorted nature of separate accounting. The taxpayer therefore did not meet the burden of proof necessary for invoking Section 304(f) relief.

CROSS REFERENCE: Chapter 28 and Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment/Unitary

COCA-COLA

Coca-Cola Company v. Oregon Department of Revenue (1975) - 533 P2d 788.

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The Coca-Cola Company was a manufacturer of soft drink syrups for fountain and bottled use. The syrups were sold to wholesale druggists, independent wholesale dealers and to approximately 900 bottling plants throughout the US. About 40 of the 900 bottlers were 100% owned by Coca-Cola. The rest were independently owned.

Coca-Cola originally filed separate apportionment returns in Oregon for the tax years 1963 - 1966. Oregon determined that Coca-Cola and its subsidiaries were involved in a unitary business relationship and, therefore, must file Oregon returns using combined apportionment. The Oregon Supreme Court agreed.

Coca-Cola argued that the wholly-owned bottling plants were treated no different than the independent bottling plants. Syrup was sold to the two types of bottlers at the same price. Intercompany sales between Coca-Cola and the subsidiaries amounted to only about 5% of the company's total sales. Coca-Cola was not significantly involved in the day-to-day management of the subsidiaries.

Oregon agreed that the wholly-owned bottlers were treated essentially the same as the independent bottlers. However, the State believed that Coca-Cola was involved in a unitary relationship with ALL of the bottlers. The independent bottlers were not included in the unitary group due to Coca-Cola's lack of ownership of the companies.

Oregon based its case, and the Oregon Supreme Court based its decision, on the following unitary factors:

* The sales of the bottled syrup were made through long-standing contracts with all of the bottlers. The contracts prevented the bottlers from buying syrups and bottling beverages from others who were in substantial competition with Coca-Cola products. All of the bottlers were wholly dependent upon Coca-Cola for the syrups used.

* Strict quality controls were imposed by Coca-Cola on all of the bottlers. Equipment and packaging was controlled by Coca-Cola for all of the bottlers.

* Advertising of the final product was primarily handled by Coca-Cola for all of the bottlers.

* Neither the independents nor the wholly owned bottlers could change their market territory without the approval of Coca-Cola.

CROSS REFERENCE: Chapter 28 and Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment/Unitary

COMPLETE AUTO TRANSIT

Complete Auto Transit v. Brady (1977) - 430 US 274.

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Complete Auto was a Michigan corporation engaged in the business of transporting motor vehicles for the General Motors Corporation. The case involved transportation services Complete Auto conducted in Mississippi. GM shipped motor vehicles by rail to Jackson, Mississippi. Within 48 hours of their arrival, the vehicles would be loaded onto trucks and delivered to various dealers in the State by Complete Auto. Mississippi sought to impose a sales tax on these sales of transportation services in Mississippi.

Complete Auto argued that the tax Mississippi was assessing was, by statute, a tax imposed on "the privilege of...doing business" within the State. The taxpayer believed that the tax was in violation of the Commerce Clause based on an earlier decision of the US Supreme Court in the case of Spector Motor Service. In the Spector case the Court held that a tax on the "privilege" of engaging in an activity in the State may not be applied to an activity that is part of interstate commerce.

The US Supreme Court decided that the tax being assessed in the Complete Auto case was NOT unconstitutional. The decision in the Spector case looked only to the fact that the incidence of the tax was on the "privilege of doing business". It did not consider the practical effect of the tax and in essence suggested that interstate commerce should be granted an immunity from taxation. Numerous US Supreme Court decisions since the Spector decision had looked at the practical effect of various tax statutes and had determined that no such blanket immunity exists. In Complete Auto the Court summarized the elements of the prior decisions by stating that a tax that was applied to an interstate activity would not be unconstitutional under the Commerce Clause simply because it was statutorily identified as a "privilege" tax. Rather, the determination of whether or not a tax was constitutional should be based on what has become known as the "four-prong test":

* Is the tax applied against an activity that has a substantial nexus with the taxing state;

* Is the tax fairly apportioned;

* Does the tax discriminate against interstate commerce; and

* Is the tax fairly related to the services provided by the taxing state.

CROSS REFERENCE: Chapter 36

TOPICAL INDEX: Nexus

CONTAINER CORPORATION OF AMERICA

Container Corporation of America v. FTB (1983) - 463 US 159, 77 L ED 2d 545, 103 SCt 2933.

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Container was a manufacturer of custom-ordered paperboard packaging. It was headquartered in Illinois and transacted business throughout the United States and, through its subsidiaries, the world. California determined upon audit that Container and its subsidiaries were involved in a worldwide unitary business relationship.

Container claimed that California's worldwide unitary business method of taxation for franchise tax purposes violated the Due Process Clause and the Commerce Clause of the Federal Constitution. Container based its arguments on three issues:

* Do Container Corporation and its subsidiaries located throughout the world constitute a unitary business group for state taxation purposes?

* Even if the unitary business group finding is proper, do certain differences between domestic and foreign operations make the worldwide unitary apportionment method unfair?

* In any event, does the worldwide unitary apportionment method violate the Foreign Commerce Clause of the Federal Constitution?

The US Supreme Court found in favor of California on all counts.

UNITARY BUSINESS ISSUE

In order for unitary apportionment to be proper, the out-of-state activities of the unitary business must be related in some concrete way to the in-State activities.

"...there must be some sharing or exchange of value not capable of precise identification or measurement - beyond the mere flow of funds arising out of a passive investment or a distinct business operation - which renders formula apportionment a reasonable method of taxation."

This was the first time the "flow of value" concept was identified. Prior to the Container decision, a unitary business relationship had to be substantiated by "tangible" evidence alone (i.e. flow of goods or services, transfers of personnel, flow and/control of funds, etc.).

In Container the Court stated:

"Investment in a business enterprise truly "distinct" from a corporation's main line of business often serves the primary function of diversifying the corporate portfolio and reducing the risks inherent in being tied to one industry's business cycle. When a corporation invests in a subsidiary that engages in the same line of work as itself, it becomes much more likely that one function of the investment is to make better use - either through economies of scale or through operational integration or sharing of expertise - of the parent's existing business-related resources."

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In other words, when two corporations are involved in the same line of business there is at least a limited presumption that the two entities share a flow of expertise that may not be tangibly measured but that indicates the existence of a unitary business relationship.

California did not base its unitary determination merely on this presumption however. Many of the "major" unitary criteria (such as intercompany sales, purchasing, etc.) did not exist so the determination was supported by tangible evidence showing that the parent assisted the subsidiaries in obtaining equipment and filling personnel needs that could not be met locally. The parent also loaned funds to the subsidiaries, guaranteed loans provided to the subsidiaries by third parties, was greatly involved in the subsidiaries' corporate expansion plans, and provided technical assistance and general management guidance.

APPORTIONMENT FAIRNESS ISSUE

Container argued that the standard 3-factor formula applied on a worldwide unitary basis was unfair and was out of appropriate proportion to the business transacted in the State. Container challenged the formula on two grounds:

* The foreign subsidiaries were much more profitable than the domestic parent, therefore, the standard 3-factor formula distorted the proper allocation of unitary group income.

* The wages of the foreign subsidiaries' workers are generally lower than the wages of the domestic workers. Since one of the factors used is based on payroll, the formula becomes distorted.

The Court rejected both of these arguments.

"The problem with [the first] argument is obvious; the profit figures relied on by appellant are based on precisely the sort of formal geographical accounting whose basic theoretical weaknesses justify resorting to formula apportionment in the first place."

The second argument, and the evidence presented to support the argument, does not impeach the basic rationale behind the 3-factor formula. Container and its subsidiaries have been determined to constitute a unitary group, therefore, it:

"...may well be that in addition to the foreign payroll going into the production of any given corrugated container by a foreign subsidiary, there is also California payroll, as well as other California factors, contributing - albeit more indirectly - to the same production."

FOREIGN COMMERCE CLAUSE ISSUE

Since Container's unitary group involved not only domestic companies but also foreign subsidiaries, the constitutionality of this method of taxation was also examined in light of the Foreign Commerce Clause.

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The US Supreme Court had previously held in the case of Japan Line, Ltd. that the risk of multiple taxation of income is enhanced when foreign commerce is involved. Also, in these cases it is very possible that a state tax will impair federal uniformity. The Court ruled that the tax being imposed in Japan Line was unconstitutional.

Although the Container case contained many similarities to the Japan Lines case there were also enough differences to cause the Court to find that the tax being imposed in Container was constitutional. For instance:

* Japan Lines involved a property tax while Container involved a tax on income.

* In Japan Lines one taxing jurisdiction was claiming the right to tax in full while the other jurisdiction was attempting to tax in part. In Container both jurisdictions are attempting to allocate the income of a multi-national enterprise.

* The tax in Japan Line fell on the foreign owners of the entities involved. In Container, the tax was imposed on the corporation domiciled and headquartered in the United States.

CROSS REFERENCE: Chapter 28

TOPICAL INDEX: Apportionment/Unitary

CONTINENTAL ILLINOIS (1975)

Department of Revenue v. Continental Illinois Bank & Trust Company (1975) - Ill App 3d 326.

On August 22, 1972, the Illinois Department of Revenue issued a subpoena duces tecum ordering Continental Illinois Bank & Trust Company ("Continental") to produce records pertaining to one of their customers, Julius W. Butler. The records were necessary to determine Mr. Butler's Illinois income tax liability for 1969 - 1971. The Circuit Court of Cook County ordered Continental to comply with the subpoena.

Mr. Butler alone appealed the decision. Mr. Butler contested the decision by taking the position that the subpoena power granted to the Department by the IITA was unconstitutional in that it violated the Due Process Clause. He maintained that the subpoena power:

* Was overly broad and open-ended,

* Neglected to require (as a precondition to the subpoena's issuance) an administrative hearing to be held,

* Caused a financial burden on the third party holder of the materials,

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* Violated the Federal and State constitutional guarantees of privacy as to both the holder of the materials and the taxpayer, and

* Illegally failed to provide the taxpayer with formal notice of an investigation.

The Illinois Appellate Court upheld the Department's subpoena. In answer to Mr. Butler's arguments, the Court held:

* The subpoena power was not overly broad. Continental was not only the holder of the information but also the owner of them. Further the Department had shown that the investigation was being conducted for a legitimate purpose, the request for information was relevant to that purpose, the information was not in the Department's possession, and the proper statutory administrative steps had been taken.

* The subpoena was issued to Continental who was not attacking the breadth, reach or financial responsibilities encountered in complying with it. Throughout the proceedings, Continental had stated that it would readily comply with the subpoena upon court order and final resolution of the challenge.

* Mr. Butler did not show any established legal privilege (such as attorney-client), any work product claim or any proprietary interest in regard to the materials which would support his contention that the subpoena would violate his privacy rights.

* Finally, Mr. Butler had sufficient notice of the investigation when he was made a party to the proceedings. Since Mr. Butler had not shown that he was injured by his lack of formal notice, no constitutional challenge would be considered.

CROSS REFERENCE: Chapter 35 - Subpoenas

TOPICAL INDEX: Subpoena

CONTINENTAL ILLINOIS (1984)

Continental Illinois National Bank and Trust Co. of Chicago v. Lenckos (1984) - 102 Ill 2d 210, 105 SCt 296.

Continental paid the audit liabilities proposed on its 1973, 1974 and 1975 returns under protest and filed a complaint in the circuit court of Cook County. Two major issues were involved in this case:

* Amortization of federally-exempt obligation bond premium.

* Inclusion of US obligation interest in the apportionment formula.

The Illinois Supreme Court found in favor of the taxpayer on both issues.

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AMORTIZATION OF BOND PREMIUM

Continental believed that the addition modification contained in Section 203(b)(2)(A) of the IITA should be computed as interest received on federally-exempt obligations net of any amortization of premium. The Department had taken the position that the addition modification should be gross interest received.

The Illinois Supreme Court decided in favor of Continental. It found that the addition modification should be interest received, net of amortization, because:

* Requiring gross interest to be added-back would result in a tax on capital rather than a tax on net income.

This was based on two US Tax Court cases involving US obligation interest and the corresponding amortization.

* In order for this provision of the IITA to be constitutional it could not arbitrarily discriminate between taxpayers. If gross federally-exempt interest were required to be added back, the provision would discriminate between holders of federally-exempt obligations and federally-taxable obligations since federally-taxable obligations are included in federal taxable income (and thus taxed by Illinois) net of amortization.

* The enactment of PA 83-561 which allows a subtraction modification for deductions related to federally-exempt obligations which are not allowed federally was a clarification of (rather than a change to) existing law.

INCLUSION OF US OBLIGATION INTEREST IN THE APPORTIONMENT FORMULA

The second major issue decided in the Continental case involved the inclusion of interest income from US Government obligations in the apportionment formula of a financial organization.

The Department took the position that the interest should be included in the apportionment formula since, although federal statutes prohibit directly or indirectly taxing the interest from these obligations, the apportionment formula is only a method of distributing income of an entity between taxing jurisdictions. The Multistate Tax Commission supported the Department's position.

The Illinois Supreme Court found that inclusion of this interest in the apportionment formula resulted in the indirect (at a minimum) consideration of a US Government obligation in the computation of a State tax. Therefore, the Court found in favor of Continental.

CROSS REFERENCE: Chapter 29 and Chapter 35 - Apportionment

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TOPICAL INDEX: Tax-exempt Interest - Amortization/Sales Factor - Interest

37.5.45. DAVEY

United States v. Davey (1976) - 543 F2d 996.

The IRS brought action seeking an order compelling compliance with a summons to require the production of 37 computer tapes comprising part of a corporate taxpayer's (Continental Corporation) financial record keeping system. The taxpayer, through its Secretary, Davey, first offered printouts in lieu of the tapes, then agreed to produce duplicate tapes if the IRS would pay for the cost of duplicating the tapes.

The court ruled that:

* The statute which allowed the IRS to compel production of books, papers, records or other data relevant or material to the examination of a tax liability, encompassed records or data stored in the form of computer tapes;

* The test of materiality and relevance was whether the inspection might throw light on correctness of taxpayer's returns;

* The statute prohibiting an unnecessary examination or investigation by the IRS did not allow a taxpayer to give the service requested information in an inconvenient form in an effort to keep from providing it in a more convenient form;

* Once the IRS had made a minimal showing of the relevancy of the sought material, the burden shifts to the taxpayer to show why a summons might represent an abuse of the courts' process that should not be enforced;

* Where the accuracy of a taxpayer's return was being checked, the IRS was entitled to use original records for purposes of verification rather than be forced to accept purported copies which present a risk of error or tampering and the IRS should not be put in a position of having to prove such error or tampering before it may use the originals;

* If the taxpayer was concerned about the safety of the tapes, it should make duplicates before complying with the summons; and

* The cost of duplicating the tapes had to be borne by the taxpayer.

CROSS REFERENCE: Chapter 35 - Subpoena

TOPICAL INDEX: Subpoena

37.5.46. JOHN DEERE PLOW COMPANY

John Deere Plow Company of Moline v. FTB (1951) - 38 Cal2d 214, 238 P2d 569.

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John Deere Company of Moline ("John Deere") was a subsidiary of Deere and Company, an Illinois corporation. Deere and Company and its subsidiaries were involved in a vertically integrated, unitary business involved in the manufacture and sales of farm equipment. Included in the affiliated group of corporations were factories, jobbing houses and retail outlets. In California, John Deere operated a jobbing house in San Francisco. This jobbing house was involved in sales in California, Arizona and Nevada. Equipment was also exported to the Orient from this location.

John Deere filed income tax returns in California using separate accounting which resulted in the California jobbing house incurring a loss for the period in question. California subsequently audited the returns and determined that John Deere was a member of Deere and Company's unitary group and its California tax liability should be computed using unitary, 3-factor apportionment.

John Deere did not dispute the fact that it was involved in a unitary relationship with Deere and Company and its affiliates. The company also conceded that the formula apportionment usually produces a reasonable result. John Deere argued, however, that IN THIS CASE that the unitary 3-factor formula was improper due to unusual conditions which occurred during the period in question -i.e. increased operating expenses and decreased financial return. Therefore, the company believed that separate accounting for the California jobbing house was the proper method to use in computing California income.

Although the California Supreme Court did not question the trial court's determination that the separate accounting records of the company accurately reflected the sales and expenses of the California jobbing house, it also did not believe that fact precluded the finding that the records did not accurately reflect the income which should be attributed to California. In relying on earlier cases the Court held that although a particular accounting system might be a useful or necessary business aid, it may not meet the requirements when a State seeks to determine its proper tax liability. In the Court's opinion, the unitary, 3-factor formula fairly calculated the portion of the unitary income of the Deere unitary group attributable to the business done within California.

"[The] plaintiff fails to take into account the underlying concept of formula apportionment in the allocation of income from a unitary business: that the unitary income is derived from the functioning of the business as a whole, to which the activities in the various states contribute; and that by reason of such interrelated activities in the integrated overall enterprise, the business done within the state is not truly separate and distinct from the business done without the state so as reasonably to permit a segregation of income under the separate accounting method rather than use of the formula method in assigning to the taxing state its fair share of taxable values."

CROSS REFERENCE: Chapter 28

TOPICAL INDEX: Apportionment/Unitary

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DOVER CORPORATION

Dover Corp v. IL Dept of Revenue. Circuit Court Cook County 8/17/93.

Issues:

A. Sales Throwbacks

Dover Corp is a unitary filer which had contested the Department's treatment of throwback sales. Dover argued that certain subsidiaries had nexus in various states and therefore the unitary group as a whole was subject to the other states' jurisdiction under IITA Section 303(f). Dover based its opinion on the Finnigan court case.

The Department takes the position that each company stands on its own when determining nexus. Also per IAC Section 100.3200(a)(2) TP's must prove not only that they are taxable in a state, but also that they paid that state's tax. This position is supported by GTE Automatic Electric v. Allphin (1977).

The court ruled in favor of the Department on this issue by saying that the Department's method assures that 100% of the business income of a corporation is allocated to some state which was the intent of the legislature. Also the act uses singular words in referring to a taxpayer. There is no reason to believe that "taxpayer" refers to a group of companies.

B. Non-business capital gains, interest, and royalties:

In the second issue the Department had claimed that capital gains, interest income, and royalties were all business income, but the ALJ had ruled that only the royalties were business income - capital gains and interest income were non-business. The court affirmed the decision of the ALJ.

1. Capital Gains and Interest Income

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This was from Schroeder fund capital gains and Eurodollar interest which resulted from investments in non-U.S. operations and managed outside of Illinois. The Department argued that the investments came from excess working capital and were made so that the TP could "gain exposure to European financial market."

The court used the guidelines given in Allied Signal case (Chapter 37, Page 16). In Allied in order for income to be business income it "must serve an operational rather than an investment function". Also in that case it was determined that the corporate strategy of acquisitions and disposals did not otherwise convert a passive investment into an operational one. The court determined that the investments were passive in nature and bear no relation to the activities of the unitary business.

2. Royalties

Unlike the capital gains and interest issue, the court affirmed that the royalties do serve an operational purpose because the patents that generated the royalties were created in the regular course of the TP's business. The decision of the ALJ that this is business income was affirmed by the court.

CROSS REFERENCE

TOPICAL INDEX

DOW CHEMICAL

Dow Chemical v. Illinois Department of Revenue (1991) - 224 Ill App 3d 263, 586 NE2d 516.

Dow Chemical originally filed its Illinois income tax returns for the years ending 1975 through 1978 on a separate apportionment basis. The Department subsequently conducted an audit on the returns (also using separate apportionment) which resulted in an additional liability being proposed. A Notice of Deficiency was issued in December 1979 which Dow protested in January 1980. After several meetings between the Department and Dow, it was determined that the case should be returned for a re-audit.

The re-audit was finalized in December 1983 and the revised results, which were based on the unitary apportionment method, revealed that Dow and the other members of its unitary group had overpaid its Illinois liability for the years in question. Dow filed an amended protest and requested the return of its overpayment. Dow's request was denied since the Statute of Limitations had expired for filing claims for the years involved.

When Dow filed its return for 1984, it attempted to credit a portion of the prior "overpayment" to offset its 1984 tax liability. A subsequent Department hearing determined that Dow was not entitled to a refund of the out-of-statute overpayment nor was the company entitled to offset any future liability by the prior "overpayment".

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Dow argued that Sections 904 and 909 of the Illinois Income Tax Act requires the Department to refund overpayments which occurred as a result of the Department's errors in calculating a taxpayer's correct tax liability even if no claim is filed. Secondly, Dow argued that the 1984 amendment to Section 909(a) which allowed the Department to collect time-barred liabilities by withholding subsequent overpayments also requires the Department to issue time-barred overpayments.
Finally, Dow argued that based upon equitable principles it should be allowed to recover its substantial overpayment.

The Illinois Appellate Court found in favor of the Department. In response to each of Dow's arguments, the Court held:

* While Sections 904 and 909 of the IITA when "viewed in isolation" would appear to support the company's contention, every section of the IITA must be read in conjunction with the rest of the Act. Section 911 states that a claim must be filed with the proper time period. Therefore, although the Department has a duty to refund overpayments, taxpayers have the duty to file proper claims to receive those refunds.

* While the 1984 amendment to Section 909(a) allowed the Department to offset liabilities for which the collection period has expired by subsequent overpayments, the language does not allow taxpayers to credit a time-barred overpayment against a subsequent liability.

* While Dow has a good argument that Illinois was in a state of confusion over the unitary issue during the years involved, it is not a persuasive one. The Department bulletin (ITIB 1975-1) which was issued stating that unitary reporting was no longer authorized in Illinois was retracted eight days later (ITIB 1975-2). The Court did not feel that the taxpayer could have relied on the first bulletin to its detriment. Dow could have filed a protective claim with the proper time period based on unitary apportionment.

CROSS REFERENCE: NONE

TOPICAL INDEX: Statute of Limitations

EDISON CALIFORNIA STORES

Edison California Stores v. McColgan (1947) - 30 Cal2d 472, 183 P2d 16.

Edison Brothers Stores, Inc. ("Edison Bros.") was organized in 1929 to hold the stock of a Georgia corporation which was involved in the retail shoe business in that state. By 1937 Edison Bros. owned and operated 15 subsidiaries, each of which operated retail stores in various states throughout the country.

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Edison California Stores ("Edison Calif.") was incorporated in California in 1932. All of its stock was held by Edison Bros. Edison Calif. was a 100% California corporation. For 1937 and 1938, Edison Calif. filed California franchise tax returns using separate accounting to compute California net income.

Various members of the Edison family were officers and directors of Edison Bros. and all of the subsidiaries. There was a centralization of the management, purchasing, distribution, store operations and advertising departments. The centralized departments set operating policies and kept the main accounting records for all of the subsidiaries. The parent corporation purchased goods for resale through its own outlets and the subsidiaries' outlets. California determined that all of the elements of a unitary business, as established in the Butler Bros. case, were present; unity of ownership, unity of operation and unity of use. Therefore, California recomputed Edison Calif.'s franchise tax liability based on the use of unitary apportionment.

Edison Calif. argued that:

* The Butler Bros. principal did not apply to this case since Butler Bros. involved one corporate entity with warehouse locations in several states and the Edison group was made up of separate corporate entities.

* The unitary formula produced an arbitrary and unreasonable result since, when using separate accounting, the California corporation incurred a loss and, when using unitary apportionment, the corporation had income.

* California had not proven that the separate accounting figures provided by Edison Calif. were not accurate, that the formula method accurately reflected the taxpayer's California income, or that tax evasion was involved.

The California Supreme Court found in favor of the State. In response to each of Edison Calif.'s arguments, the Court held:

* All of the elements of a unitary group were present. Thus the business was unitary regardless of the fact that Butler Bros. involved one corporation with several branches and Edison Calif. involved a parent corporation and numerous subsidiaries. "If the crux of the matter is to ascertain that portion of the business which is done within this state, then the same considerations justify the use of the formula allocation method in [Edison Calif.] as in [Butler Bros.]."

* Once the determination was made that the corporation was a member of a unitary business then unitary apportionment was necessary to properly allocate income to the State. It then became the responsibility of the taxpayer to prove that the formula produced an unreasonable result. While Edison Calif. was able to prove that its separate accounting entries were accurate and reasonable, the company did not prove that the unitary apportionment result was not. It is not necessary to prove that tax evasion is present before use of an apportionment formula is allowed.

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CROSS REFERENCE: Chapter 28 and Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment/Unitary

ERIEVIEW CARTAGE, INC.

Erieview Cartage Corporation v. Illinois Department of Revenue. June 28, 1993

Erieview Cartrage Company filed a petition with the Illinois Circuit Court regarding a notice of deficiency issued by the Department of Revenue in the amount of $21, 080.56. The central question in the case was whether or not the Erieview Corporation was subject to the Illinois tax.

Erieview argued that it neither earned or received income in the State of Illinois so as to be subject to taxation under the Illinois Tax Act. The Company asserts that since it does not exist in Illinois, income was not received in Illinois. The Company also claims that the liability based on possible income earned in Illinois does not apply because they only provide the administrative guidance in the transport of goods. The actual transporting of goods is provided by independent contractors. They assert that all of their activities take place outside the State. Erieview also seeks to add a constitutional aspect to the case. They held that the imposition of this tax would impede interstate commerce.

The Department offers the four prong test of Complete Auto Transit as the basis for its decision of taxing the Corporation: The tax is applied to an activity with a substantial nexus with the taxing State, does not discriminate against interstate commerce, and is fairly related to the services provided by the State. The Department states that the tax is only attributable to trucks traveling in Illinois and serving Illinois customers. The Department asserts that there were sufficient pick ups and deliveries in Illinois to establish the requisite nexus. The Court found that on average there were two deliveries and pick ups per day within Illinois during the tax period.

The Court also stated that although the truck drivers were independent contractors, they were under Erieview's complete control and the Company had exclusive possession of the vehicles. The Company had complete responsibility for the trucks for the duration of the period.

The Court stated that pick ups and deliveries in Illinois were part of Erieview's normal business operations. The Court affirmed the decision of the Administrative Law Judge and the notice of deficiency was issued.

CROSS REFERENCE:

TOPICAL INDEX:

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EXXON

Exxon Corp. v. Wisconsin Department of Revenue (1980) - 447 US 207, 65 L ED 2d 66, 100 SCt 2109.

EXXON was a vertically integrated petroleum company. Its organizational management structure, during the years in question, consisted of three parts: Corporate Management, Coordination and Services Management, and Operations Management. The third level of management, Operations Management was responsible for directing the operations of the functional departments of the company. The three major functional departments were: Exploration and Production, Refining and Marketing. The only activity carried on by EXXON in Wisconsin was marketing. EXXON performed no exploration, production or refining operations in the State.

When EXXON filed its income tax returns in Wisconsin for 1965 through 1968 it utilized the separate accounting method to arrive at its Wisconsin tax liability. This was possible since the company treated each of its functional departments as separate investment centers.

Sales of products and raw materials from Exploration and Production to Refining and from Refining to Marketing were theoretically based on competitive wholesale market prices and were accounted for as such.

Wisconsin audited the returns filed by EXXON for 1965 through 1968 and determined that "the Wisconsin marketing operation was 'an integral part of the unitary business,' and therefore EXXON's taxable income in Wisconsin must be determined by application of the State's apportionment formula to the taxpayer's total income." The US Supreme Court ultimately agreed with Wisconsin.

The Court held that:

* EXXON had not carried its burden of showing that its functional departments were discrete business enterprises. "While EXXON may treat its operational departments as independent profit centers, it is nonetheless true that this case involves a highly integrated business which benefits from an umbrella of centralized management and controlled interaction." For instance,

** The Coordination and Service Management level provided many essential corporate services for the entire company, including the coordination of the refining and other operational functions.

** Many of the items sold by EXXON in Wisconsin were obtained through a centralized purchasing office in Houston. This allowed OVERALL corporate profits to increase through bulk purchases and efficient allocation of supplies among the retailers.

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** The gasoline which was sold in Wisconsin was available through an agreement between EXXON and Pure Oil Company in Illinois. This agreement was arranged by the Supply Department (which was part of Coordination and Services Management) and the Refining Department (which was part of Operations Management).

** Sales were facilitated through the use of a uniform credit card system, uniform packaging, common brand names and common promotional displays, all of which were controlled through EXXON's national headquarters.

* EXXON's contention that a prior decision in the case of Moorman Manufacturing Company sanctioned the use of separate functional accounting in order to prove the extraterritorial reach of a state tax statute and that its accounting records proved that the apportionment formula utilized by Wisconsin violated the Due Process Clause was rejected. A company's internal accounting records are not binding on a State for tax purposes. The Court felt that nothing in the Moorman case led to the conclusion that a taxpayer's separate function accounting MUST be accepted, as a matter of constitutional law, for state tax purposes.

* EXXON's contention that the rejection of the use of separate accounting subjected interstate business to an unfair burden of multiple taxation in violation of the Commerce Clause was also rejected. While there may be a RISK of multiple taxation, none was PROVEN to exist. "In short, the Commerce Clause does not require that any income which a taxpayer is able to separate through accounting methods and attribute to exploration and production of crude oil and gas be allocated to the States in which those production centers are allocated. The geographic location of such raw materials does not alter the fact that such income is part of the unitary business of the interstate enterprise and is subject to fair apportionment among all States to which there is a sufficient nexus with the interstate activities of the business."

CROSS REFERENCE: Chapter 28 and Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment/Unitary

FARMERS AND TRADERS STATE BANK

Farmers and Traders State Bank v. J. Thomas Johnson (1984) - 76 Ill Dec 565, 121 Ill App 3d 43.

The major issue involved in this case was whether or not the interest earned on Ginnie Mae and Fannie Mae certificates was constitutionally immune or statutorily exempt from state taxation.

The Illinois Appellate Court relied heavily on their prior decision in the case of Montgomery Ward Life Insurance Company v. Department of Local Government Affairs (1980) and US Supreme Court's decision in the case of Smith v. Davis (1944).

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NOTE: Refer to Para.s 37.5.76 and 37.5.93 for synopses of these cases and the complete case citations.

Ginnie Mae certificates are issued by a financial institution or mortgage servicing company. The certificates are backed by a pool of government insurer or guaranteed mortgages. GNMA guarantees that the issuer will make timely payments of principal and interest. The issuer is primarily responsible for making all payments. If the issuer fails to make these payments, the certificate holder's sole recourse is against GNMA. GNMA has the right in this instance to consider the issuer in default of the original agreement and become the owner of the mortgages involved.

In the case of Smith v. Davis the Supreme Court held that obligations which were constitutionally exempt from state and local taxation have four characteristics:

* They are written documents.

* They bear interest.

* They contain a binding promise by the United States to pay specified sums at specified dates.

* They have specific Congressional authorization, which also pledged the faith and credit of the United States in support of the promise to pay.

In the case of Montgomery Ward, the Illinois Appellate Court found that with GNMAs the private issuer has the primary responsibility to make monthly interest payments and to repay the principal. The payment obligation of the GNMA is indirect and speculative. In addition, the Court determined that Ginnie Maes are not issued by a government agency to borrow money on the credit of the United States to finance an essential governmental function. Rather, the obligations were guaranteed by GNMA to improve their marketability and encourage people to invest in them. Therefore, the interest received on Ginnie Mae certificates is not constitutionally or statutorily exempt from state and local taxation.

The Court also used the GNMA analysis above to determine whether or not interest received on Fannie Mae certificates was exempt. According to title 12 USC Section 1716 - 1719 (1976), FNMA was created by Congress to operate as a reserve market for mortgage investors and to facilitate the distribution of government capital for home mortgage financing. In 1968, ownership of FNMA was transferred to the private sector. Congress did not intend for Fannie Mae certificates to be guaranteed by the United States nor should they be considered debts or obligations of the United States or any agency or instrumentality thereof. Since Fannie Mae certificates do not carry a binding promise by the United States to pay specified amounts at specified dates, and they do not have congressional authorization pledging the full faith and credit of the United States in support of the promise to pay, the Court held that interest earned on Fannie Mae certificates was not exempt from state taxation.

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CROSS REFERENCE: Chapter 29

TOPICAL INDEX: US Interest - GNMA/FNMA

FARRAND COAL

Farrand Coal v. Halpin (1957) - 10 Ill 2d 507.

This was a Retailers' Occupation Tax case in which Farrand Coal claimed that the coal which it sold to the city of Springfield for use in its electric plant was a sale for resale and, therefore, was not subject to ROT. Farrand contended the it was actually selling the energy in coal to the Springfield utility which then transferred the energy into electrical energy for sale to the ultimate consumers. The case centered on the definition of tangible personal property as it pertained to "energy".

In the absence of a statutory definition (as in this case) indicating a different legislative intention, words have their ordinary and popularly understood meanings. Webster's Dictionary defined "tangible" as that which is capable of being touched. The Illinois Supreme Court held that "energy" did not meet the definition of "tangible" as that word is ordinarily or popularly understood.

"From the evidence it appears that although energy and mass are closely interrelated, indestructible, equivalent, interchangeable, directly proportional to and may be equated with each other...energy cannot be separated from mass or matter and stored, weighed, transported, handled, liquefied, solidified, photographed, touched or otherwise perceived by the senses in its own right or capacity separate and apart from mass or matter."

The Court found, therefore, that the sale of coal to the utility was a sale of tangible personal property, however, it was not a sale for resale since the coal was used by the utility to create electrical energy and ELECTRICAL ENERGY WAS NOT TANGIBLE PERSONAL PROPERTY.

CROSS REFERENCE: Chapter 30

TOPICAL INDEX: Tangible Property

FILTERTEK

Filtertek, Inc. v. Illinois Department of Revenue (1989) - 186 Ill App 3d 208.

Filtertek was a manufacturer and seller of plastic molded filters. Originally Filtertek had a subsidiary, Filtertek de Puerto Rico, which was also engaged in the manufacture and sale

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of filters to customers in the United States and Puerto Rico. In 1975 the subsidiary was "spun off".

In 1980 and 1981, over 50% of the stock of both companies was owned by the same individual. The two companies were in the same line of business. The two firms had many common directors and officers and had many intercompany transactions such as intercompany sales and loans. Products which were purchased from Filtertek de Puerto Rico by Filtertek were shipped to Illinois, where the products were repackaged and shipped to Filtertek's customers all over the world.

The Department argued that Filtertek and Filtertek de Puerto Rico were unitary businesses. In audit, products that were purchased from Filtertek de Puerto Rico and were resold by Filtertek, were included in the numerator of Filtertek's sales factor based on the rules for sales of tangible personal property. A large number of these sales were considered Illinois throwback sales since Filtertek was not taxable in the destination jurisdictions. Filtertek argued that the sales transactions between Filtertek and Filtertek de Puerto Rico were merely "transshipped" through Illinois to destinations outside of Illinois since most of the time the products were only in Illinois for a few days.

The Illinois Appellate Court found that Filtertek and Filtertek de Puerto Rico constituted a unitary business. The fact that an individual provided the common ownership requirement did not prohibit the two companies from constituting a unitary group. The intercompany activities and common management supported the unitary grouping.

The Court further found that the transactions between Filtertek and Filtertek de Puerto Rico were actually sales since Filtertek took title to the products and was responsible for delivery, quality and collection problems. The amount of time that the products stayed in Illinois was immaterial in determining whether or not they were Illinois sales for sales factor purposes.

The final argument raised by Filtertek was that the Statute of Limitations for issuing a Notice of Deficiency had elapsed on 1980 since the Department failed to provide Filtertek with an approved copy of the extension agreement. Again, the Court disagreed and found that there had been an offer of an extension by the Department, an acceptance by Filtertek, and a communication of that acceptance to the Department by Filtertek. No further communication was necessary.

The Illinois Supreme Court refused to review the Appellate Court's decision.

CROSS REFERENCE: Chapter 28 and Chapter 33

TOPICAL INDEX: Apportionment/Sales Factor - Throwback Sales/Unitary

FINNIGAN

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Appeal of Finnigan Corp., CAL SBE 8/25/88 - CCH California State Income Tax Reporter, Para. 401-653, rehearing reaffirmed 1988 decision, 1/24/90.

Finnigan Corporation was engaged in a unitary business which manufactured and sold scientific instruments in numerous states and foreign countries. The unitary business involved various subsidiaries including one known as Disc Instruments. Disc was a California corporation which manufactured and sold equipment both inside and outside of California. Disc itself was not taxable in any state into which it made sales but California but Finnigan was taxable in those other states.

California determined that Finnigan should have computed its unitary sales factor by "throwing back" to California the sales made by Disc to the states in which Disc was not, itself, taxable. Finnigan disagreed stating that California was interpreting the term "person" to mean one individual corporation when computing the sales factor and to mean all of the corporations included in the unitary group for other apportionment formula computations.

The California SBE agreed with Finnigan stating that for purposes of the sales factor, the term "taxpayer" should refer to all of the corporations in the unitary group. Therefore, if any member of the unitary group is taxable in a state, sales made to that state by any member of the group cannot be "thrown back" to California.

The California Franchise Tax Board petitioned the Board of Equalization for a rehearing to clarify whether it was the intent of the SBE to overturn their 1966 decision in the Appeal of Joyce, Inc. The SBE refused to grant the rehearing and, therefore, reaffirmed the result of their earlier decision and overruled Joyce.

ILLINOIS IS NOT FOLLOWING THE CALIFORNIA STATE BOARD OF EQUALIZATION DECISION IN THE CASE OF THE APPEAL OF FINNIGAN CORPORATION. ILLINOIS WILL CONTINUE TO FOLLOW THE JOYCE RULE.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Sales Factor - Throwback Sales/Unitary

FIRESTONE TIRE AND RUBBER COMPANY

Firestone Tire and Rubber Company v. FTB (1978) - 87 Cal App 3d 878, 151 Cal Rptr 460.

A California Court of Appeal issued a preliminary injunction requiring Firestone Tire and Rubber Company ("Firestone") to provide information which was necessary and relevant for California to determine the company's proper state franchise tax liability. Firestone was further required to allow the FTB access to officers, directors, employees or agents of Firestone or any of its subsidiaries for the purpose of obtaining information pertinent to the

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audit. Finally, Firestone was required to give the State photocopies of any of the above information, if requested.

The Court required the State to specifically identify in writing to the company all of the documents necessary, giving the company 2 weeks to provide the requested information. The State was also required to give 2 weeks advance notice of any request to interview personnel of Firestone and its subsidiaries.

CROSS REFERENCE: Chapter 35 - Subpoena

TOPICAL INDEX: Subpoena

FIRST AMERICAN NAT'L BK OF NASHVILLE

First American National Bank of Nashville v. United States of America (1972) - 72-2 USTC Para. 9694, 467 F2d 1098.

First American National Bank of Nashville ("First American") was involved in three types of transactions involving federally tax-exempt obligations which the Internal Revenue Service examined.

* First American entered into agreements with security dealers to purchase federally tax-exempt obligations from issuers of the obligations and, at a later date sell the obligations to security dealers. The dealers agreed to purchase the obligations at the same price as the bank had originally paid. The bank accrued interest on the bonds between the time when the bond was originally purchased from the issuer until the bond was sold to the dealer.

* First American entered into oral agreements with other customers of the bank to purchase federally tax-exempt obligations from security dealers and later sell them to the customers at the same price, with adjustments for accrued interest. The bank accrued interest on the bonds between the time when the bond was purchased from the dealer until the time is was sold to the customer.

* First American purchased federally tax-exempt obligations from dealers and later sold the bonds to various trust for which the bank acted as trustee. The obligations were kept in the bank's regular investment account until they were purchased by the trust. When the trusts purchased the obligations, they paid the bank the cost of the obligations plus accrued interest.

In each of these "repurchase agreement" arrangements, First American reported the interest received as federally tax-exempt interest. The IRS disagreed with First American's "tax-exempt" classification.

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The US Court of Appeals agreed with the IRS by stating that none of the interest received by the bank in any of the three types of transactions described above constituted tax-exempt interest. The Court found that the bank was actually lending money to persons to purchase the obligations and securing those loans with the obligations. In this way the bank was able to completely insulate itself from the risk of market fluctuations since it was assured of receiving the price it had originally paid for the bonds. The bank was actually a secured lender instead of a bond owner.

The Court further explained that allowing the bank to report the interest income it received from these repurchase agreements as tax-exempt income would result in a double tax benefit. The bank is reporting the interest received on the obligation as tax-exempt interest and is "loaning" money to person whom is ultimately going to buy the bond without receiving any interest income from the person.

CROSS REFERENCE: None

TOPICAL INDEX: US Interest - Repurchase Agreements

FLOOM

People v. Floom (1977) - 52 Ill App 3d 971.

Center Liquors, Inc. and its president, Leonard Floom, refused to produce the company's books and records in order for them to be examined by a representative of the Illinois Department of Revenue in violation of Section 7 of the Retailers' Occupation Tax Act. In a case which was consolidated with Floom on appeal, Sam Haas – treasurer of Arem, Inc. - had provided the Department's representatives with the books and records but refused to allow them to take notes, make ledger sheets or copy the materials. The taxpayers argued that the ROT Act allowed the Department to make a cursory physical examination to determine that the books and records existed but did not grant the Department the authority to "audit" those books and records.

The Illinois Appellate Court found that the taxpayers were in violation of the ROT Act and the Department's ROT Rules and Regulations. Section 7 of the ROT Act provides that:

"All books and records...shall, at all times during business hours of the day, be subject to inspection by the Department or its duly authorized agents and employees."

The Appellate Court held that the word "inspection" has a broader meaning that just to physically look at the records. It means to examine carefully or critically, or to investigate and test officially. The power to inspect also includes the power to copy the records. The legislature by specifically granting the Department the authority to "inspect" the records also intended to imply the power to audit the records in order to determine the correct amount of tax which was due under the ROT Act.

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CROSS REFERENCE: Chapter 27 and Chapter 35 - Subpoena

TOPICAL INDEX: Photocopying Information/Subpoena

FOODWAYS NATIONAL, INC.

Foodways National, Inc. v. Department of Revenue. Connecticut Supreme Court - 05/17/94

Foodways, a multi-state frozen food manufacturer established contracts with public warehouses, but there was ambiguity concerning a Connecticut statute. The property factor used to compute the corporation business tax was in question. Foodways Corporation conducted a significant amount of business in the state of Connecticut, and was assessed a Corporation business tax. The Foodways Corporation wanted to include their warehouse storage fees as a rent expense, but the Department of Revenue determined that this expense could not be classified as a rent expense. The case was first heard in the Connecticut Superior Court.

The issues were:

1. The characterization of "gross rents", as it relates to its inclusion in the corporation business tax property factor for purposes of apportionment of income. The Foodways Corporation wanted to include their warehouse fees in the property factor of the apportionment statute, but the Commissioner did not include their warehouse storage fees as a rent expense. The Commissioner cited the statute (s-12- 218), that defines a rent expense as tangible property.

2. The ambiguity surrounding the statute which governs whether only payments for the rental of tangible personal property are inculpable in the property factor, caused the discrepancy to occur between the two parties. The Connecticut Supreme Court ruled that the taxpayer properly included payments for warehouse storage fees in the property factor for apportionment of income. The decision of the lower court was to be reversed and the case was remanded with the direction to sustain the appeal.

*** Under the rules of Statutory interpretation, any ambiguity in a statute that seeks to impose a tax must be resolved in favor of the taxpayer.*****

CROSS REFERENCE:

TOPICAL INDEX:

GELDERMANN AND COMPANY INC.

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Geldermann and Company Inc. v. Oregon State Tax Commission - Oregon Tax Court, No. 2000, July 2, 1985.

An out-of-state commodities futures brokerage was subject to corporate excise tax because nexus with the state was established by an agency relationship maintained with an Oregon commission salesman. Evidence that the Oregon salesman acted as an agent rather than an independent contractor included the following:

* Prior to trading, customers were required to sign agreements with the out-of-state broker;

* Trade confirmations and statements were sent from the broker; and

* The Oregon salesman was an officer with the brokerage firm and represented himself as such to customers.

CROSS REFERENCE: Chapter 36

TOPICAL INDEX: Nexus

GTE AUTOMATIC ELECTRIC

GTE Automatic Electric, Inc. v. Allphin (1977) - 68 Ill 2d 326.

When filing its Illinois Income Tax returns for 1971 and 1972, GTE Automatic Electric ("GTE") included in the numerator of the sales factor, sales with a destination of Illinois and sales with an origin of Illinois and a destination in a state in which GTE was not taxable (single throwback sales). During an audit of these returns, the Department requested information regarding the following two types of sales:

* Sales of TPP shipped by GTE's supplier from the supplier's inventory in a state in which GTE was not taxable to purchasers in states in which GTE was not taxable (drop-shipment sales), and

* Sales of TPP shipped by GTE's supplier from the supplier's inventory in Illinois to purchasers in states in which GTE was not taxable (direct sales).

GTE refused to provide the information and asked for a summary judgement from the courts stating that these types of sales should not be included in the Illinois numerator of the sales factor and that the Department be stopped from requesting such information.

The Illinois Supreme Court found that although Section 304(a)(3)(B) of the IITA did not expressly address "drop-shipment sales", these sales could be included in the sales factor under, what is now, Section 304(f). To include these sales in the denominator of the sales factor and not in the numerator of any state would create a distorted sales factor.

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The Court further found that the "direct" sales fell within the provisions of Section 304(a)(3)(B)(ii) - throwback sales. The fact that GTE had no control over which inventory the supplier used to fill the order was determined to be immaterial. The origin of the sale was Illinois even though it was shipped from a supplier's inventory instead of GTE's.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Sales Factor - Throwback Sales

HANS REES' SONS

Hans Rees' Sons v. State of North Carolina (1931) - 283 US 123, 51 SCt 389.

Hans Rees' Sons ("Hans Rees'") was engaged in the business of tanning, manufacturing and selling belting and other heavy leathers. Its only manufacturing plant was located in North Carolina however some finishing work was performed at a location in New York. The company's primary sales office and warehouse were located in New York although some sales were made from North Carolina and some shipments were also made from there. The company was involved in both wholesale and retail sales.

North Carolina allocated a portion of the company's income for income tax purposes through the use of a 1-factor apportionment formula based on property. This apportionment method resulted in approximately 80% of the company's income being allocated to North Carolina.

Han Rees' disagreed with North Carolina contending that the apportionment formula used was arbitrary and unreasonable and, therefore, in violation of the 14th Amendment to the Constitution.

Hans Rees' provided evidence breaking up the company's profits in each year into three pieces:

* Buying profit which resulted from their skill and efficiency in purchasing hides in a fluctuating market.

* Manufacturing profits which resulted from the difference between the cost of tanning performed on contracts and the cost of performing this activity at their North Carolina plant.

* Selling profit which resulted from the method of cutting the leather into small parts as to meet the needs of a given customer. Using this method, the average amount of income attributable to North Carolina was 14% (the manufacturing profits).

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The US Supreme Court agreed with Hans Rees'. The Court held that although North Carolina's 1-factor apportionment formula was not unconstitutional on its face, the facts of this case (based on the evidence presented by the company) proved that the formula was arbitrary and unreasonable to Hans Rees'. The highest amount of the profit attributed to manufacturing in any year involved was 27%, far less than the 80% which resulted from the use of the apportionment formula. This was true even though the company had attributed all of the manufacturing profit to North Carolina even though some of the manufacturing profit was created by the finishing work performed in New York.

The Court rejected North Carolina's argument that Hans Rees' was a unitary business operation which began with the purchasing of raw material, ran through the manufacturing process and ended with the sales of the products to consumers, therefore, it was unfair to break the company's profits in segments (i.e. buying, manufacturing, selling). Although the Court agreed that Hans Rees' was a unitary operation, it did not believe that fact allowed North Carolina to tax an amount of income that was out of all proportion to the business transacted within the state. The Court felt that Hans Rees' had met its burden of proof in showing that North Carolina' apportionment formula created an unfair result.

CROSS REFERENCE: Chapter 35 - APPORTIONMENT

TOPICAL INDEX: Apportionment

JOHN I. HAY COMPANY

Fontenot (Louisiana) v. John I. Hay Company (1955) - 228 La 1031, 84 So2d 810.

The John I. Hay Company was a common carrier which transported cargo on the Illinois Waterway, the Mississippi River, the Ohio River and the Gulf Intracoastal Waterway. None of its shipments originated or terminated in Louisiana. The company maintained an office and had employees in the State. Louisiana sought to impose an income tax on the company's Louisiana income based on the use of a revenue miles apportionment formula.

The company contended that Louisiana was attempting to tax interstate commerce in violation of the Constitution of the United States. The Louisiana Supreme Court found, however, that the State was not attempting to tax interstate commerce but, rather, was taxing the company's net income which was attributable to its interstate business done or performed within the borders of the State. Further, the Court held, it was necessary to use a formula to determine the Louisiana income since,

"[The] defendant does not carry a load from New Orleans, Louisiana to Houston, Texas gratis, nor does it only charge to carry a load from the Louisiana State border to Houston; it charges for the whole trip. Therefore, every part of the charge on loads in Louisiana is in payment of the transportation in Louisiana."

CROSS REFERENCE: None

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HERFF JONES COMPANY

Herff Jones Company v. Oregon (1965) - 430 P2d 998.

Herff Jones Company did business in Oregon through four resident salesmen who were actually employees of Master Engravers, Inc. The State Tax Commission determined that Herff Jones's activities in Oregon were sufficient to create nexus and, therefore, assessed an income tax liability against the company. Herff Jones maintained that the salesmen were independent contractors and, as such, their activities in Oregon did not exceed the limitations of PL 86-272.

An overview of Herff Jones' activities in Oregon follows:

* Herff Jones had a contract with Master Engravers, Inc. making Master Engravers the franchise agent for Herff Jones in several states including Oregon. Master Engravers employed 4 resident salesmen in Oregon who sold products (primarily at schools) for Herff Jones, Master Engravers and several other companies.

* Herff Jones provided each salesman with $3000 to $5000 worth of merchandise for use as samples. The samples remained the property of Herff Jones and the company would deduct any sample loss from the commission paid to the salesman.

* Master Engravers (rather than Herff Jones) provided the salesmen with automobiles but Herff Jones carried liability insurance on the cars. Herff Jones also carried a fidelity bond on the salesmen and deducts the premiums paid from the commission paid to the salesmen.

* The salesmen were required to obtain a $5 deposit on every ring sold. The orders were sent to Indianapolis by the salesmen and the rings were shipped COD or open account directly to the buyer. The salesmen or the school officials are allowed to collect the balance due on the rings and forward it to Herff Jones but credit approvals and account collections are usually the responsibility of Herff Jones.

* Herff Jones has no property in Oregon with the exception of the salesmen's samples.

* Herff Jones pays the commissions to Master Engravers who then pays the salesmen. The franchise agreement between Herff Jones and Master Engravers requires Master Engravers to employ a sales manager who is subject to approval by Herff Jones.

The Supreme Court of Oregon found in favor of the State. The Court first sought to determine whether or not the salesmen constituted representatives of Herff Jones or independent contractors. If the salesmen were found to be independent contractors, they

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could perform many more activities in Oregon before the protection of PL 86-272 would be forfeited.

The Court stated that, "[t]he single most important factor in determining whether an individual is an independent contractor or a servant is the right to control or interfere with the manner and method of accomplishing the result - not the actual exercise of control. Under this test, it is apparent that [Herff Jones'] salesmen are not independent contractors."

Herff Jones required the salesmen to post bonds, carry automobile insurance for Herff Jones' benefit and not compete with Herff Jones if the contract was terminated. Herff Jones also controlled the salesmen's territories. Herff Jones' contract with Master Engravers also gave Herff Jones the right to approve the hiring of a sales manager and the right to approve the hiring and firing of the salesmen. Finally, Herff Jones supplied order blanks with its name on them for use by the salesmen and also supplied samples and advertising materials to the salesmen. "It is clear from these facts...that [Herff Jones] desired to control the activities of its sales representatives."

Once the Court determined that the salesmen were representatives of Herff Jones rather than independent contractors, it was apparent that the salesmen's activities in Oregon exceed the solicitation of orders which is permitted by PL 86-272. Therefore, the Court found that Herff Jones' activities in Oregon were sufficient to create nexus and the company was liable for Oregon State income tax.

CROSS REFERENCE: Chapter 36

TOPICAL INDEX: Nexus

THE HOLDING COMPANY

The Holding Company v. Illinois Department of Revenue (1991) - 214 Ill App 3d 390.

No original return was on record as being filed by The Holding Company for the tax year ending August, 1980. On July 1, 1982, the taxpayer filed an IL-1120X carrying back a 1981 NOL to 1980. The IL-1120X reported that no tax had originally been paid for 1980, therefore, no refund was now claimed.

In October, 1982 the Department notified the company that there was no record of an original return for 1980 having been filed. Although the company provided copies of federal documents, no proof of an original Illinois return was received. The Department issued a Notice of Deficiency for the tax (and applicable penalty and interest) due in 1980 prior to the 1981 carryback. The Holding Company took the case through Administrative Hearings, to court.

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The Illinois Appellate Court found that an IL-1120X did not constitute an original return and the tax, penalties and interest as proposed by the Department were correct.

CROSS REFERENCE: Chapter 33

TOPICAL INDEX: Statute of Limitations

HONOLULU OIL CORPORATION

Honolulu Oil Corp. v. FTB (1963) - 386 P2d 40, 34 Cal Rptr 552.

Honolulu Oil Corp. ("Honolulu") had its principal offices in San Francisco. The operations both within and without the state were controlled to a very large extent from California, as well as the accounting, purchases of equipment and supplies, insurance, and legal fees. Honolulu's operations were divided into five geographical divisions: California, Mid-continental, Canadian, Rocky Mountain, and Southeastern.

The president of Honolulu exercised a great deal of control over the divisions, and each division manager worked closely with company executives. Both parties agreed that Honolulu's business done within the state was dependent upon or contributed to its business done without the state.

Honolulu argued that all of its operations were unitary in nature and, therefore, it should be allowed to determine its California net income through the use of an apportionment formula (comparing its California property, payroll and sales to its everywhere property, payroll and sales) rather than through separate accounting.

The FTB argued that Honolulu was not the typical "integrated" oil company and was not vertically integrated. There was not the significant flow of goods that was usually found in oil companies.

Further, the FTB argued that the three unites test had not been met because central performance of "service" functions was not sufficient to support a conclusion of a unitary operation and that unity at the "operating level" was essential to such a conclusion. As such, the FTB concluded that Honolulu's California operations should be accounted for separately from its operations outside of the state.

The California Supreme Court found in favor of Honolulu by determining that all of Honolulu Oil's,

"...out-of-state production and processing is made possible as the result of its prior exploration and development, utilizing funds which became available through prior production of other wells, personnel and know-how from company-wide resources. Exploration and development are not an end in themselves, but are only the forerunner of production and processing in Honolulu's scheme to create revenue. Extensive

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intercompany assets and efforts were devoted to each producing well, wherever it may be located, and the mere fact that production and sale therefrom are a local operation does not transform that operation to something distinct and apart. To the contrary it becomes an integral part of the unitary business, and thereafter contributes its share to future exploration and development efforts in other areas."

CROSS REFERENCE: Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment/Unitary

HOWARD JOHNSON COMPANY

Howard Johnson Co. v. Illinois Department of Revenue (1982) - Circuit Court of Cook County.

Howard Johnson maintained an investment portfolio which consisted of Treasury bills, banker acceptances, commercial paper, state and municipal bonds and preferred stock. The portfolio was originally funded from a public offering of common stock, an exercise of employee stock options and excess earnings. A certain portion of the income earned on the portfolio was used for working capital, the remainder was reinvested.

Howard Johnson argued that the income was non-business since:

* The interest income had no connection to the hotel and restaurant business.

* The assets were located in New York and had no connection to Illinois.

* Over 75% of the funds were not used for working capital and the fact that they were available for use was immaterial.

* The income earned from the fund was earned outside of Illinois and had no connection to activities in Illinois.

The Department argued that:

* The investment fund was a working capital reserve.

* The fund enhanced the financial stability and worthiness of the business as a whole.

* Regulation Section 300-2(c)(2)(ii)(c) states that if the assets producing the non-business income exceeds 10% of the taxpayer's current assets the income will be presumed to non-business income. (This regulation section is no longer in existence).

The Circuit Court found that:

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* Although the fund was not essential to the taxpayer's trade or business it contributed to and was identifiable with that business.

* The acquisition of the fund was integral to the business. The proceeds of the fund were designated by Howard Johnson to be for equipment, leasehold and other land improvements and working capital required for the expansion of the hotel and restaurant operations.

* The fund was anchored on short-term securities.

* Even though it might not have been necessary to use the funds in the business, the existence of the funds is reflected in the working capital and stockholder reports, therefore, "...the management basked in the financial glow of its stability."

* The same management personnel managed the fund and the hotel and restaurant operations.

* The New York fund was not a discrete business operation from the hotel and restaurant business.

The court concluded that the income from the investment portfolio was business income. Although the funds were not actually used (to any great extent) during the audit period, the court felt that the ability to use the fund and the relative liquidity of the fund (since the money was primarily invested in marketable securities) made the income business in nature.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Non-business Income

HYGRADE FURNITURE TRANSPORT

Hygrade Furniture Transport, Inc. v. New York Tax Commission (1986) - TSB-H-86(16)C; Corporation Tax.

Hygrade Furniture Transport, Inc. ("Hygrade") identified its principal business activity as a "Freight Forwarder Acting as Agent". Hygrade contracted with furniture and department stores to deliver furniture to the stores' customers. Hygrade would then contract with independent truckers to do the actual hauling of the freight.

Hygrade owned no trucks nor did it employ any drivers. The independent truckers paid all of their own expenses. Hygrade was paid by the stores and the truckers were paid by Hygrade on a commission basis. Hygrade reported all of the income from the stores as revenues and included the commissions (about 70% of the amount received from the stores) in Costs of Goods Sold.

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Hygrade's contracts with the stores stated that Hygrade was "...in the business of providing delivery service for retail furniture stores...". Hygrade further agreed to provide sufficient vehicles and personnel to meet the delivery obligations of the stores and agreed to maintain cargo insurance and to pay for loss or damage to the goods "caused solely by [Hygrade's] employees."

Hygrade argued that it was not providing a transportation service but, rather, was acting as a broker, arranging for services between the stores and the independent truckers. Hygrade further argued that if it were determined to be providing transportation services, only 30% of the revenue received should be considered Hygrade's income since the other 70% was paid to the truckers.

The State Tax Commission found that Hygrade was providing transportation services.

"That inasmuch as petitioner's entire business activities consist of the provision of transportation and petitioner holds itself out to the public as a provider of such services, it is subject to tax...Petitioner does not merely act as a conduit through which furniture stores may enter into contracts with independent truckers. Petitioner enters into the contracts and agrees that it will provide the service and accept responsibility for any damages it may cause. Petitioner then employs the truckers to perform the work. The truckers are employed by petitioner, not the furniture stores and, therefore, it is petitioner who is providing the transportation service."

In the second issue the Commission found that the revenue received by Hygrade from the furniture stores constituted gross earnings to Hygrade. The amounts paid to the truckers were considered costs of doing business.

CROSS REFERENCE: Chapter 35 - Transportation Companies

TOPICAL INDEX: Transportation Companies

ILLINOIS V KENTUCKY

State of Illinois v. Commonwealth of Kentucky (1991) – 111 SCt 1877.

The case came before the US Supreme Court in order to determine the location of the correct boundary between Illinois and Kentucky in the Ohio River. Kentucky contended that the boundary was the low-water mark of the Ohio River, as it exists from time to time. Illinois, on the other hand, argued that the boundary was the low-water mark of the Ohio River, as it was when Kentucky became a state in 1792.

The US Supreme Court found in favor of Illinois following the Court's previous decisions in the cases of Indiana v. Kentucky (1890) and Ohio v. Kentucky (1980). However, since no

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accurate maps of the river exist from the 1790's, the Court remanded the case to the Special Master to determine the exact location of the "1792 line".

In March of 1993 the Attorney Generals of Illinois and Kentucky reached an official agreement, establishing the boundary between the two states. Under that agreement,

* The boundary will be set at a minimum of 100 feet from the Illinois shore of the Ohio River. At some points, the Illinois border will extend farther into the river.

* The low-water mark of the Ohio River will be determined by a "digitized" map created by the US Geological Survey however, the boundary will be adjusted in Illinois' favor if the low-water mark is less than 100 feet from the Illinois shore.

* Kentucky will retain possession of several parcels of land that were islands in Kentucky territory at one time but which have since become attached to the Illinois shore due to the changing shape of the river.

CROSS REFERENCE: Chapter 35 - Transportation Companies

TOPICAL INDEX: Transportation Companies

IRON FIREMAN MFG. CO.

Iron Fireman Manufacturing Co. v. Oregon (1968) - 445 P2d 126.

Iron Fireman Manufacturing Company ("Iron") was an Oregon corporation engaged in the manufacturing of air frame components, subassemblies and assemblies, primarily for the Boeing Aircraft Company in Seattle, Washington. The company had an extremely close relationship with Boeing. The company's activities in Washington included:

* An Iron manager spent a substantial amount of time at Boeing selecting the items his company wanted to bid and persuading Boeing that Iron was qualified to manufacture the items.

* Many of Iron's officials made regular trips to Boeing to take care of "manufacturing problems, installation problems, repair work, redesign discussions [and] production problems" which occurred after the work had started to manufacture the products.

* Iron had production workers, metallurgists, quality control managers and assembly supervisors who spent several weeks of the year at Boeing.

* When Iron hired a new metallurgist to work with Boeing, several Boeing officials interviewed applicants with Iron. Also, prior to going to work for Iron, the metallurgist was required to spend several weeks at Boeing for indoctrination.

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* Iron had a contract administrator who worked with Boeing on schedule disputes, change incorporations, and with Boeing's legal counsel.

* On some occasions Iron's assembly supervisor went to Boeing when Boeing was conducting an equipment quality analysis.

The Oregon Supreme Court found that Iron had conducted sufficient activities in Washington to make them taxable in that state and, therefore, Iron was entitled to apportion its income between Oregon and Washington.

CROSS REFERENCE: None

TOPICAL INDEX: Nexus

J.C. PENNEY COMPANY

Wisconsin v. J.C. Penney Co. (1940) - 311 US 435.

Wisconsin imposed a tax on dividends called the Privilege Dividend Tax. The tax was "for the privilege of declaring and receiving dividends out of income derived from property located and business transacted in the state." At issue was whether or not this tax violated the Due Process Clause of the Constitution as applied to corporations which were domiciled in a state other the Wisconsin (foreign corporations) and, therefore, declared dividends in those other states. In the enforcement of this tax against foreign companies, the amount of income attributable to Wisconsin was calculated using the same apportionment formula as that employed in assessing the regular corporate income tax on earnings.

J.C. Penney had their principal offices in New York. Corporate meetings, at which dividends were voted upon, were held in New York and the dividend checks were drawn upon New York bank accounts.

The US Supreme Court held that Wisconsin was attempting to income which had no relationship to the company's activities within the state and, therefore, was in violation of the Due Process Clause.

The Court's most frequently cited and quoted test of the due process standard can first be found in this case.

"That test is whether property was taken without due process of law, or whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return."

CROSS REFERENCE: Chapter 36

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TOPICAL INDEX: Nexus

JOYCE, INC.

Appeal of Joyce, Inc., CAL SBE 11/23/66, CCH California State Income Tax Reporter, 1966 Cal Tax LEXIS 18.

Joyce, Inc. was a California corporation, involved in the manufacture and sale of women's shoes and footwear. During the fiscal years ending November 1959, 1960 and 1961 its only activities in California were some minor leasehold improvements and the presence of representatives who only solicited orders within the State.

In 1955 US Shoe acquired in excess of 90% of Joyce, Inc.'s stock. U.S Shoe was an Ohio corporation who also manufactured and sold women's shoes and footwear. US Shoe's only business activity in California, prior to the acquisition of Joyce, Inc. was the solicitation of orders by company representatives. US Shoe also had two other wholly-owned subsidiaries who had absolutely no contact with California.

The California FTB determined that US Shoe, Joyce, Inc. and the other subsidiaries constituted a unitary business group and should, therefore, file a combined return for California Franchise Tax purposes. In computing the unitary group's California net income, the State included in the numerator of the factors, the payroll and sales in California of both US Shoe and Joyce.

US Shoe argued that it was not involved in a unitary relationship; that separately reporting Joyce's income to California was the proper method to determine the net income attributable to the State; and, if combined reporting was required, the California payroll and sales of US Shoe should not be included in the combined factors since US Shoe itself was protected by PL 86-272.

The California State Board of Equalization found that US Shoe and its subsidiaries (including Joyce, Inc.) were involved in a unitary business relationship and that separately reporting Joyce's income did not fairly or accurately attribute the unitary group's California income. However, the SBE further held that the California payroll and sales of US Shoe could not be included in the numerators of the unitary groups factors since US Shoe ITSELF did not have nexus in California.

"Pursuant to PL 86-272, no state has the power to impose a tax on or measured by income derived within the state by any person if the only business activities within the state are the solicitation of orders for tangible personal property, which orders are sent outside the state for approval or rejection and if approved, are filled by shipment or delivery from a point outside the state. Specifically excluded by this federal statute from this immunity are corporations incorporated in the state where the activity occurs. Accordingly, the net income which [Joyce] as part of the unitary group derived from

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sources within this state was included in the measure of tax, whereas the net income of US Shoe derived from sources within this state was not included."

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Nexus/Sales Factor - Throwback Sales

JAPAN LINE, LTD.

Japan Line, Ltd. v. County of Los Angeles (1979) - 441 US 434, 99 SCt 1813.

California attempted to impose a property tax on cargo containers owned by certain Japanese shipping companies. The containers were based, registered and subjected to property tax in Japan and were used exclusively in foreign commerce. There were always some containers in California although no specific container was there for more than a short period of time. The containers were involved in no intrastate or interstate transportation of cargo except as continuations of international voyages.

California felt they had the authority to impose the property tax on the foreign owned containers since they had met the four-pronged test found in Complete Auto. They believed that the containers had a "substantial nexus" with the State because some of the containers were present in California at all times. The tax was "fairly apportioned" since it was levied only on the containers' "average presence" in the State. Thirdly, the tax "[did] not discriminate" since it was imposed on all personal property in California. Finally, the tax was "fairly related to the services provided by" California since it was protected by the police and fire departments, had a trained work force in California using the containers and "had the advantages of a civilized society."

The US Supreme Court held in favor of Japan Line, Ltd. The Court found,

"When a State seeks to tax the instrumentality of foreign commerce, two additional considerations, beyond those articulated in Complete Auto, come into play. The first is the enhanced risk of multiple taxation...Second, [does] the tax prevent the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments?' If a state tax contravenes either of these precepts, it is unconstitutional under the Commerce Clause...Analysis of California's tax under these principles dictates that the tax, as applied to [Japan Line, Ltd.'s] containers is impermissible."

CROSS REFERENCE: None.

TOPICAL INDEX: Nexus.

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KEYSTONE CONSOLIDATED INDUSTRIES (1977)

Keystone Consolidated Industries v. Allphin (1977) - 45 Ill App 3d 714.

Keystone Consolidated Industries had entered into a contractual agreement with another company, Chemetron, for the construction and operation of a plant which would produce gaseous oxygen and nitrogen. Chemetron's plant would be located on property owned by Keystone in Peoria, Illinois. The gases were produced by processing air from above and around the Chemetron plant.

The Illinois Department of Revenue assessed a use tax on the monthly purchases of the gases by Keystone. Keystone disagreed with the assessment stating that they were purchasing a service rather than tangible personal property, therefore, no use tax was due.

The Illinois Appellate Court found in favor of the Department of Revenue. By examining the agreement which was executed, several provisions indicated that the transfer of oxygen and nitrogen was intended to be a transfer of ownership of property. "The gases are tangible personal property and as such are subject to the use tax."

CROSS REFERENCE: Chapter 30

TOPICAL INDEX: Tangible Property

KEYSTONE CONSOLIDATED INDUSTRIES (1995)

Keystone Consolidated, Inc. v. Illinois Department of Revenue January 6, 1995.

Keystone Consolidated Industries protested a notice of a tax deficiency issued by the Department of Revenue. The Notice of Deficiency was issued as the result of a federal RAR that increased the federal taxable income of the Keystone Corporation, for TYE 6/30/80. Keystone attempted to offset the proposed deficiency by revisiting net operating losses previously denied or not pursued. The Department of Revenue denied the petition based on the premise that the Statute of Limitations had expired. The taxpayer also argued that since the Department may issue a Notice of Deficiency at any time if the taxpayer fails to report a federal change, the taxpayer should be entitled to offset the additional liability with tax attributes available to it. The Administrative Law Judge stated that there was no basis in the law to support this particular claim. He ruled in favor of the Department of Revenue in this case.

CROSS REFERENCE:

TOPICAL INDEX:

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KRAFT, INC. (ILLINOIS)

Kraft, Inc. v. Roger D. Sweet (1991) - 213 Ill App 3d 889.

Kraft contended that, although Subpart F income was not technically a dividend, it should be considered as a constructive dividend for purposes of the IITA subtraction modification for foreign dividends received. Kraft further believed that treating Subpart F income and dividend income in a different manner was unconstitutional. Finally, Kraft asserted that the 1987 amendment to the IITA which permitted Subpart F income to be included in the foreign dividend subtraction modification for tax years ending on or after December 31, 1988, was actually a clarification of, rather than a change to, existing law.

The Illinois Appellate Court found that Subpart F income is not a dividend. The IRC does not provide that Subpart F income is a dividend, in fact some portions of Subpart F income provide no benefit to the domestic corporation required to report the income. The Court further found that Subpart F income is treated in a different manner than dividend income, a real and substantial difference exists between the two types of income. The differing treatment is not, therefore, unconstitutional. Finally, the Court held that the legislative debate for PA 84-1455 clearly showed that the General Assembly intended to make the amendment prospective only.

In October 1991 the Illinois Supreme Court denied the taxpayer's appeal of the Appellate Court decision.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Subpart F Income

KRAFT, INC. (IOWA)

Kraft, Inc. v. Iowa Department of Revenue and Finance (1992) - 112 SCt 2365.

During 1981, Kraft General Foods, Inc. was involved in a worldwide unitary business relationship with its affiliates. Iowa required Kraft to file a separate company return.

Iowa uses federal taxable income as a starting point for state taxation. Since the IRC allows a 100% deduction for dividends received from domestic subsidiaries, no domestic dividends are included in the Iowa tax base. No corresponding deduction is allowed federally for dividends received from foreign subsidiaries and Iowa has no foreign source dividend subtraction modification or foreign tax paid credit, therefore, foreign source dividends are included in the Iowa tax base.

Kraft believed that the Iowa tax structure was discriminatory. Iowa argued that no discrimination was present since:

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* A domestic corporation's dividends might reflect some foreign operations and a foreign corporation's dividends might reflect some domestic operations. Therefore, the differing tax treatment of foreign and domestic dividends did not translate into discrimination on the basis of location or nature of business activity.

* Kraft could have avoided the tax related to the foreign dividends by setting up a domestic subsidiary with no Iowa presence to receive the dividends and then pass income through the domestic subsidiary to Kraft.

* The tax structure did not favor Iowa companies over out-of-state companies.

* The tax structure did not favor domestic business activities in general over foreign business activities. Domestic subsidiaries are taxed by the federal government and other states while foreign subsidiaries generally are not. The differing tax treatment for foreign and domestic dividends helped to balance the differing federal and state tax treatments for foreign and domestic subsidiaries.

* Finally, even if the tax structure was discriminatory, it was valid since it promoted administrative convenience for both the taxpayer and the State rather than economic protectionism. Starting with federal taxable income allows taxpayers to compute their Iowa tax liability easily and the Iowa authorities can rely on federal regulations to monitor tax compliance.

The US Supreme Court found that the Iowa tax structure was unconstitutional in that it discriminated against foreign commerce.

The Court held that:

* The foreign subsidiaries were clearly operating in foreign commerce and the decision to do business abroad was for legitimate business reasons. The fact that Kraft and its foreign subsidiaries were involved in a unitary relationship showed that Kraft was involved in foreign commerce. Iowa was attempting to tax foreign dividends, therefore, it was attempting to tax foreign commerce.

* The State could not force a taxpayer to conduct its foreign business through a domestic subsidiary in order to a avoid discriminatory taxation of foreign commerce, therefore, the fact that Kraft could have avoided the tax by structuring its business in a different manner was irrelevant.

* While it was true that the statute did not treat Iowa businesses more favorably than out-of-state businesses, this was not a crucial element when determining a violation of the Foreign Commerce Clause.

* "We find no authority...for the principle that discrimination against foreign commerce can be justified if the benefit to domestic subsidiaries might happen to be offset by other taxes imposed not by Iowa, but by other states and by the federal government."

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* While not attempting to minimize the value to the states of replicating federal rules and practices, absent a compelling justification, a state cannot discriminate against foreign commerce because of administrative ease. Iowa could easily eliminate the discrimination without causing an administrative burden by creating a subtraction modification for foreign source dividends.

CROSS REFERENCE: None

TOPICAL INDEX: Foreign Source Dividends

KROGER

Kroger Company v. Kentucky Department of Revenue (1977) - Kentucky Board of Tax Appeals, No. K76-R-22, Order No. K-4742.

The Kroger Company originally filed its Kentucky income tax returns claiming capital gains, rental income, royalty income and interest income as non-business income. Upon audit, the Kentucky Department of Revenue reclassified the income as business in nature and included it in apportionable income. The Kentucky Board of Tax Appeals found in favor of the State.

* The capital gains arose from the sale of land, buildings and equipment which was previously used in the production of business income by Kroger. When the company decided to close a particular store, all of the buildings, land and equipment was sold. In addition, the company would purchase the residence of a store manager if the manager was transferred to another location and was not able to timely sell his or her residence. The company would then sell the residence, usually at a profit. The company claimed depreciation expense for all of the above property and the depreciation expense offset business income.

The Kentucky Board of Tax Appeals found that the capital gains were business income.

* The rental income also occurred when the company closed a store. In these cases, the land, building, etc. had been leased rather than owned by Kroger. When the company closed a store at a leased location, the company would attempt to sublet the land, buildings, etc. for the remainder of the lease period.

The Kentucky Board of Tax Appeals found that the rental income was business income since the store had "turned over" (closed old stores and opened new stores) 60% of its stores within 5 years. As such the Board determined that closing stores and disposing of remaining leases was an incidental part of the company's business activities.

In addition, when Kroger sublet the stores for less than the original lease amount, Kroger claimed the resulting loss as a business loss and used it to offset business income.

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Therefore, the Board determined that Kroger had no basis to claim any resulting income as non-business income.

* The royalty income arose from two sources. The first was the Tender Ray Process of meat tenderizing. The process was developed as a joint venture with the Westinghouse Company.

The second source of royalty income was a "diffuser" which re-circulated air to a cooling system in the summer and a heating system in the winter. Both the tenderizing process and the diffuser were developed for use by Kroger and, therefore, any royalty income was business in nature.

* Interest income resulted primarily from loans to subsidiaries and from the sale of closed stores and warehouses. A lesser amount of interest income was earned from short-term investments.

The Board found that the company's loans to its subsidiaries arose out of or were created by a business activity since Kroger and its subsidiaries were involved in a unitary business relationship. The Board further found that the interest from the sale of the closed stores was definitely related to the company's business activities and, finally, that the interest from the short-term investments was income produced from a use of working capital. Therefore, all of the interest income should have been classified as business income.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Non-business income

LA PINE SCIENTIFIC COMPANY

La Pine Scientific Company v. Lenckos (1981) - 95 Ill App 3d 955, 420 NE2d 655.

In 1954, the Illinois Department of Revenue issued final assessments under the Retailers' Occupation Tax Act against Arther S. La Pine and Company (aka La Pine Scientific Company). In 1957, the Department's subsequent action-in-debt was dismissed due to the expiration of the applicable statute of limitations.

In 1977, the company's Illinois income tax return reflected no tax due for the year, however, the company had made estimated payments which it was now requesting to be refunded. In 1978 the Comptroller's office notified the company that its 1977 income tax refund was being withheld to pay off the 1954 assessments pursuant to Section 10.05 of the State Comptroller Act. Section 10.05 states that any time a person is entitled to a refund (warrant) from the state, the Comptroller will notify any taxpayer of any liability to the State which is "due and payable" and will then reduce the refund by the amount of the unpaid liability.

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La Pine Scientific Company contested the withholding of the 1977 refund arguing that,

* The 1954 assessments did not meet the "due and payable" requirement of Section 10.05 of the State Comptroller Act, and

* Section 10.05 of the State Comptroller Act (which was created by PA 77-2807, effective January 8, 1973) could not be applied retroactively to a 1954 assessment.

The Illinois Appellate Court first held that both La Pine and the Department were proceeding on the mistaken premise that Section 10.05 was a new collection remedy available to the State by PA 77-2807.

This was not the case. In reality this collection remedy had been available to the State for almost 100 years. Prior to the adoption of the new Illinois Constitution in 1970, the duties of the Comptroller were performed by the Auditor of Public Accounts. Section 12 of "An Act to revise the law in relation to the auditor of public accounts" contained nearly identical language to Section 10.05 of the State Comptroller Act. In actuality, PA 77-2807 merely continued to provide the State with the same collection remedy which had long been available.

The sole issue for the Appellate Court to decide was, therefore, whether or not the 1954 assessments were "due and payable". The trial court had found that the debts were not "due and payable" since their collection was barred by the expiration of the statute of limitations. The Appellate Court disagreed.

"Statutes of limitations affect the remedy by limiting the period within which legal action may be brought or remedies may be enforced; they bar the right to sue for recovery but do not extinguish the debt which remains as before...[The assessments] had not been "extinguished" as the trial court found but were merely unenforceable in a court of law. As such, the assessments are still claims "then due and payable" for purposes of section 10.05 and were properly set off against plaintiff's tax overpayment"

CROSS REFERENCE: Chapter 41

TOPICAL INDEX: Statute of Limitations

LAKEHEAD PIPELINE COMPANY

Lakehead Pipeline Company v. Illinois Department of Revenue (1989) - 192 Ill App 3d 756.

Lakehead Pipeline Company ("Lakehead") filed Illinois income tax returns for 1973 through 1975 using a two-factor formula based on barrel miles and property to compute its Illinois business income. This two-factor formula had been approved by the Director of the Department of Revenue in 1970. For 1976 and 1977 Lakehead filed Illinois returns using

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a three-factor formula. In audit, the apportionment formula on each of these returns was changed to the previously approved two-factor formula. Lakehead paid the audit liability and then filed claims for 1973 through 1977 using the three-factor formula. The Department determined that the approval of the two-factor formula had been in error and that Lakehead should have filed all of the years using the statutory one-factor barrel miles formula. The claims were correspondingly reduced. Lakehead felt that the statutory one-factor formula was distorted and pursued the case through Administrative Hearings and into court.

The Illinois Appellate Court found that Lakehead did not meet its burden of proof in showing that distortion occurred through its use of the statutory one-factor formula. The primary business conducted in Illinois was the transport of oil through its pipelines. The Court did not believe that the difference between the one and three factor formula percentages was significant.

Lakehead argued that ANY difference in the formulas was enough to require the Department to allow Lakehead to use the three-factor formula. The Court disagreed.

"The chosen formula must be applied unless it unreasonably and arbitrarily attributed to Illinois a percentage of income out of all proportion to the business transacted."

The Illinois Supreme Court refused to review the case.

CROSS REFERENCE: Chapter 35 - Apportionment and Chapter 35 - Transportation Companies

TOPICAL INDEX: Apportionment/Pipelines/Transportation Companies

LAUREL PIPELINE COMPANY

Laurel Pipeline Co. v. Commonwealth of Pennsylvania May 5, 1995.

Laurel Pipeline Company appealed a decision of a lower court regarding its disposition of an idle pipeline. The Commonwealth Court and the Board of Finance refused to characterize as non-business income the gain on the sale of a pipeline that had been idle for three years. The Pipeline Company is an Ohio Corporation engaged in the business of transporting refined petroleum products from refinery and pipeline connections from the Philadelphia area to Pittsburgh and intermediate points. The Company decided to shift its distribution patterns and because of the shift and insufficient volume, Laurel disconnected operation of the Aliquipa-Cleveland pipeline in 1983. On December 22, 1986 the Company sold this pipeline for a profit of $3,766,047. After the disposition, the Company distributed the gain to its stockholders in the form of dividends. None of the proceeds were used by Laurel to acquire any assets for use in future business operations or to generate income for use in future business operations.

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The Pennsylvania Department of Revenue refused to classify the gain as non-business income citing the functional test for classifying income. The Department contended that the sale of the pipeline constituted income from tangible property that was sold and it served as an integral part of the taxpayer's regular trade or business. The Supreme Court of Pennsylvania disagreed with that assertion. The Supreme Court held that the pipeline was not disposed of as an integral part of Laurel's regular trade or business. Rather, the Court said, the effect of the sale was that the company liquidated a portion of its assets. This is evidenced by the fact that the Company did not reinvest back into the operations of business, but they distributed the gain entirely to stockholders. The Court reversed the decision of the lower Court and it classified the profit from the disposition of property as non-business income.

CROSS REFERENCE:

TOPICAL INDEX:

LEITGEN, LOYAL AND BARBARA

Loyal and Barbara Leitgen v. Internal Revenue. U.S. Court of Appeals, 8th Circuit. 8/20/82

Loyal and Barbara Leitgen were owners of a small business, the Atlantic East Company. In 1972 they reported a net operating loss of $21,821.26. They were seeking to establish a carryover assessment of their operating loss and apply it to the years, 1973, 1974, and 1975. After reviewing their case the Commissioner decided that they were not entitled to the carryover, due to their lack of evidence concerning their supposed net operating loss. He examined their income for the three years in question and assessed tax deficiencies in the amounts of; $4,781.58, $567.65, and $1,091.00, respectively.

The Issues Continued:

1. The Leitgens claimed that the Commissioner was barred from assessing and challenging the reported loss, due to the expiration of the statute of limitations, but this was not the case. Although the statute of limitations for assessment had expired for the year in which the taxpayers claimed they suffered a loss, the Commissioner was not barred from challenging the amount of the loss. The Leitgens also argued that, section 172 of the Tax Code (which states that a loss be carried back three years before it can be carried forward), did not apply in their case because they were foreign residents during the three years preceding their loss. The District Court rejected both contentions, and found that the Leitgens failed to substantiate the amount of the 1972 loss. The Court also found that the Leitgens failed to establish that the loss could not have been applied three years back to the years 1969, 1970, and 1971. The Leitgens failed to present verifiable proof that they actually incurred a loss for the year in question.

*** The Court of Appeals affirmed the judgement of the Circuit Court***

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CROSS REFERENCE:

TOPICAL INDEX:

LEWIS V REYNOLDS

Lewis v. Reynolds (1932) - 284 US 281, 52 SCt 145.

In 1921 a federal income tax return was filed for Arthur Cooper (deceased). Tax, as reflected on the return, was paid. Upon review by the IRS an additional deficiency was assessed on the return which was paid on March 21, 1926. In July 1926 a refund of the additional amount of tax paid was requested.

In May 1929, the IRS informed the trustees to Mr. Cooper's will that a further review of the returns determined that the actual liability for the tax year exceeded all of the amounts previously paid. However, since the collection of any additional tax was barred by the statute of limitations, the claim would be denied but no additional deficiency would be assessed. The trustees argued that once the statute of limitations had expired the Commissioner lacked the authority to re-determine and reassess the tax.

The US Supreme Court found,

"...the ultimate question presented for decision, upon a claim for refund, is whether the taxpayer has overpaid his tax. This involves a re-determination of the entire tax liability. While no new assessment can be made, after the bar of the statute has fallen, the taxpayer, nevertheless, is not entitled to a refund unless he has overpaid his tax. The action to recover on a claim for refund is in the nature of an action for money had and received and it is incumbent upon the claimant to show that the United States has money which belongs to him...While the statutes authorizing refunds do not specifically empower the Commissioner to re-audit a return whenever repayment is claimed, authority therefore is necessarily implied. An overpayment must appear before refund is authorized. Although the statute of limitations may have barred the assessment and collection of any additional sum, it does not obliterate the right of the United States to retain payments already received when they do not exceed the amount which might have been properly assessed and demanded."

CROSS REFERENCE: Chapter 29, Chapter 33 and Chapter 41

TOPICAL INDEX: Claims/Statute of Limitations

LOUIS DREYFUS CORP.

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MADISON GAS AND ELECTRIC COMPANY

Madison Gas and Electric Company v. Commissioner of Internal Revenue (1979) - 72 TC 521.

Madison Gas and Electric Company ("Madison") was a Wisconsin corporation which was an operating public utility, engaged in the production, purchase, transmission and distribution of electricity and the purchase and distribution of natural gas since its incorporation in 1896.

The issue of primary interest in this case involved whether or not the agreements which Madison had entered into with two other electric utility companies for construction and operation of a nuclear power plant created a partnership for federal income tax purposes.

As part of its plan to meet consumer energy demands, Madison joined Wisconsin Public Services Corporation and Wisconsin Power and Light Company in constructing coal and nuclear plants and certain transmission facilities. Further Madison and the other two companies entered into various agreements including one entitled, "Joint Power Supply Agreement".

The Agreement provided that:

* The three utility companies wished to obtain the benefits of advanced technologies and the economies of scale to make the most effective use of the power facilities by sharing in the ownership and operation of the facilities.

* Madison would be admitted into the power pool agreement with the other two companies which allowed each of the utilities to share the others' reserve generating capacity. The utilities could also buy and sell each others' capacity to equalize the reserves of each company.

* The three companies would construct and own a nuclear plant as tenants-in-common.

* The three companies would plan for the construction of a future plant to be owned as tenants-in-common.

Madison argued that the above agreement did not create a partnership. It was Madison's position that the arrangement had no profit motive and, therefore, lacked a necessary requirement for being considered a partnership. Madison felt that only a co-ownership and expense-sharing arrangement was created from its agreement with the other two utility companies. The company cited IRC Regulations Section 1.761(a) and Section 301.7701-3(1) of the Procedural and Admin. Regulations which provided that "a joint undertaking merely to share expense is not a partnership".

The IRS contended that, based on the definition of a partnership which is included in Section 7701(a)(2), the agreement did constitute a partnership and that this position was

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further supported by the fact that Madison and the other companies elected under Section 761(a) to not be subject to the provisions of subchapter K of the IRC.

The United States Tax Court found in favor of the Internal Revenue Service on this issue. The Court did not agree that an arrangement had to have a profit motive in order to be considered a partnership. While the profit motive or business activity test is important in distinguishing between a partnership and co-ownership of property, it is not the only test for what constitutes a partnership. Further, the Court felt that the arrangement did have a profit motive since, "...a group of business organizations decide[d] to band together to produce with economies of scale a common product to be distributed to members of the venture in kind."

CROSS REFERENCE: Chapter 35 - Oil & Gas Companies

TOPICAL INDEX: Oil and Gas Companies/Partnerships

MADISON PARK BANK

Madison Park Bank v. Zagel (1982) - 91 Ill 2d 231.

In 1974 Madison Park Bank incurred a large federal net operating loss. The Bank carried the 1974 loss back to offset federal taxable income in 1971. Also in 1974, the Bank had federally-exempt interest in excess of their federal NOL which they were required to add back on their Illinois return. Since the Department did not allow Illinois Line 1 to be less than zero, the Bank was notified that additional money was due on the 1974 return. The Bank took the case to court.

The Illinois Appellate Court found that the Department had no authority for limiting Illinois Line 1 to zero. If "federal taxable income" was actually a federal loss, that negative number should be allowed as a starting point for Illinois tax computations. However, the Appellate Court further found that double deductions were expressly prohibited by the IITA. Since the taxpayer had already received the benefit of reducing income in the carryback year (1971) they could not also receive the benefit of offsetting Illinois income in the current loss year. The court instructed the Bank to amend its 1974 return and pay the resulting liability, which the Bank did.

The Department appealed to the Illinois Supreme Court. The Court refused to issue a decision on this case since the Department had appealed on the basis that Madison Park was being allowed a double deduction by offsetting income in the loss year and in the carry year. Once Madison paid the "double deduction" liability, the issue was moot. However, the Illinois Supreme Court vacated (voided) the Appellate Court's decision to prevent other taxpayers from being
allowed to receive the benefits of a double deduction.

CROSS REFERENCE: Chapter 41

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MCDONNELL DOUGLAS

McDonnell Douglas Corporation v. Franchise Tax Board, California Court of Appeal, Second Appellate District, Division Four, No. B064073, July 7, 1994, 26 CA 4th 1789, 26 CA 4th 808, 31 C Rptr 712, Modified August 8, 1994.

McDonnell Douglas Corporation "MDC" is a Maryland corporation, with aircraft manufacturing facilities located at Long Beach, California. Most of the aircraft manufactured at the Long Beach facility are delivered to the customer at the facility itself, or at a facility in Yuma, Arizona. The customers must make all transportation arrangements from these delivery points. The majority of the aircraft purchased have a final destination outside of California.

California code determines the amount of franchise taxes owed to the state according to a complex formula which takes into account, among other criteria, three factors "(1) the value of real and tangible personal property owned or rented and used in California during a specified year (the 'Property factor'); (2) the amount paid for employee compensation in California during a specified year (the 'payroll factor'); and (3) sales made in California during a specified year (the 'sales factor'). This case centers on what is included in the "sales factor" portion of the formula.

This method of franchise tax calculation is derived from the Uniform Division of Income for Tax Purposes Act (UDITPA), which has been adopted by over 20 states. The express general purpose of the UDITPA is to standardize state corporate income tax laws and "to make uniform the law of those states which enact it." (Section 25138; Times Mirror Co. v. Franchise Tax Bd., Supra, at p. 874.)

Section 25135 of the California Regulations states "Sales of tangible personal property are in this state if: (a) The property is delivered or shipped to a purchaser, other than the United States government, within this state regardless of the f.o.b. point or other conditions of the sale."

The State argues that the above section should be read by placing the emphasis on the phrase "delivered...to a purchaser...within the state," referring to the place where the purchaser takes physical possession of the property (place of delivery approach). The states position is strongly supported by its prior administrative rulings and regulations promulgated by the franchise tax board itself.

MDC, on the other hand, utilizes case law from other UDITPA jurisdictions to show that emphasis should be placed on the phrase "purchaser...within the state." The "state" being the state where the purchaser is located (destination approach). Under this approach MDC sales to customers from outside of California, who took delivery in California and if

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the aircraft's final destination is outside California, would be excluded from the sales factor for California (thereby lessening the California tax).

The court ruled that, even though the administrative regulations and rulings are entitled to great weight, the administrative regulations and rulings which make up the foundation of the states' case were simply "administrative opinions." The court found that by placing the emphasis on the delivery and not on the destination the California rule would be contrary to the rule adopted by several other states (Georgia, Connecticut, Ohio, Colorado, Minnesota, Wisconsin and Florida).

In addition, if the court adopted the states' position, the California rule would run completely against the UDITPA's stated purpose of trying to ensure uniformity among the ratifying states. The court found in favor of MDC and excluded the sales to purchasers outside of California, even if the property was delivered in California, as long as the aircraft's final destination was outside of California.

TOPICAL INDEX: Sales Factor - In-state delivery of goods with an out-of-state final destination

MELAMED, LEO AND BETTY

Leo and Betty Melamed v. Illinois Department of Revenue. March 30, 1994.

The plaintiffs, Leo and Betty Melamed, were appealing a decision made by an administrative law judge concerning a claim for a refund of Illinois income tax. They argued that they were entitled to offset their arbitrage interest costs against their arbitrage interest income and report only the net amount as income for Illinois income tax purposes. The Melameds claimed that they were entitled to subtract the interest income received in one tax year on the basis that it was a recovery of interest expenses paid in the previous tax year. They based their conclusion on the Illinois Income Tax Act (section 2-203(2)(h)). The primary issue in this case was whether the interest expense in interest arbitrage transactions and reverse repurchase agreements could be offset against arbitrage income notwithstanding a Federal change in which the interest expense was reclassified from Federal Schedule E to Federal Schedule A on the plaintiff's Federal 1040 income tax returns. The court of appeals ruled that the Melameds were not entitled to subtract their interest income as a recovery of interest previously paid. They affirmed the judgement of the circuit court.

CROSS REFERENCE:

TOPICAL INDEX:

MERCK

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Multistate Tax Commission v. Merck and Company (Ore SCt 1980), 617 P2d 1371.

This case was on appeal from a judgement and order of the State Tax Court, requiring the taxpayer to make available to auditors of the Multistate Tax Commission designated documents and key personnel for purposes of a joint income tax audit on behalf of several states.

The court ruled, in part, that the commission's order for production of numerous records, documents and witnesses, and in particular seeking production of corporate minutes, interviews with corporate officers, lists of other officers' names, job descriptions, corporate organization and function charts, worldwide payroll records, worldwide apportionment factor data and schedules and working papers which supported financial statements, tax returns and published financial reports was not shown to be broader than required by needs of the particular investigation.

CROSS REFERENCE: Chapter 35 - Subpoena

TOPICAL INDEX: Subpoena

MIAMI CORPORATION

Miami Corporation v. Illinois Department of Revenue (1991) - 212 Ill App 3d 702.

Miami Corporation ("Miami") was founded for the purpose of overseeing the Deering family's personal investment portfolio. Income was received through investments in real estate, stocks and other securities.

Real estate, which was owned in Louisiana, included 250,000 acres of land on which oil and gas deposits were discovered after the land was purchased. Miami contended that the original purchase price of the land did not reflect its true value, therefore, inclusion of the land in the property factor at original value created a distortion in the apportionment formula.

The Illinois Appellate Court found in favor of Miami. In one part of the decision the court stated that the capitalized rent expense on an office located in Chicago, Illinois was valued higher than the 250,000 of Louisiana property containing oil and gas reserves. The Court felt that Miami had met the requirements of Section 100.3700(a)(4) and proved that the statutory formula created a distorted result.

THE DEPARTMENT ISSUED AN ACTION ON DECISION SHORTLY AFTER THE APPELLATE COURT'S DECISION IN THE MIAMI CASE WAS ISSUED STATING THAT THE MIAMI CASE WAS VERY FACT SPECIFIC IN NATURE. IN GENERAL, THE ARGUMENT THAT PROPERTY HAS INCREASED IN VALUE SINCE ITS PURCHASE IS NOT GOING TO BE PERSUASIVE IN PROVING DISTORTION AND WILL NOT ALLOW SECTION 304(f) RELIEF TO BE GRANTED.

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CROSS REFERENCE: Chapter 35 - Apportionment and Chapter 35 - Oil & Gas Companies

TOPICAL INDEX: Apportionment/Oil and Gas Companies

MISSISSIPPI VALLEY BARGE LINE

Ott v. Mississippi Valley Barge Line Company, et al. (1949) - 336 US 169, 69 SCt 432.

Louisiana and the City of New Orleans took this consolidated action against Mississippi Valley Barge Line Company ("Mississippi") and several other barge lines to the US Supreme Court. The case involved the propriety of the ad valorem taxes of the State of Louisiana and the City of New Orleans as they were imposed on barge lines.

Mississippi and the other barge lines were foreign corporations which transported freight in interstate commerce up and down the Mississippi and Ohio Rivers. Each barge line had an office in Louisiana but its principal place of business was in another state.

Tugboats brought the barges to New Orleans where the barges were left for unloading and reloading. The tugboats then brought the barges to ports outside of Louisiana. The barges were at the Louisiana port for only the short periods of time necessary to unload, reload and make necessary repairs.

Louisiana and the City of New Orleans imposed ad valorem taxes based on the ratio between the Louisiana miles and the miles everywhere for the line. Two lower courts had found in favor of the barge lines stating that the companies had no tax situs in Louisiana. The US Supreme Court disagreed.

The Court saw no practical difference so far as either the Commerce Clause or the Due Process Clause was concerned whether the company uses barges or railroad cars to move freight in interstate commerce. The problem under the Commerce Clause is to determine the proper portion of the company which can be taxed by any state. The Due Process Clause is concerned only with whether the tax imposed has a reasonable relation to the opportunities, benefits or protection received by the taxing state.

"We can see no reason which should put water transportation [at least as it applies to transportation on inland waterways] on a different constitutional footing than other interstate enterprises."

The propriety of the apportionment formula was not an issue since the type of apportionment formula which was being used by Louisiana and the City of New Orleans had been viewed as acceptable on its face in prior Court decisions and the barge lines did not attempt to prove that the formula was distorted as it applied to their particular set of facts.

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The Court also found in favor of the State and City on the second issue of whether or not the barge lines had nexus in Louisiana. Although the property being taxed was not regularly or habitually in Louisiana for the whole taxable year, the formula was being used to arrive at an average portion of property which was present within the state during the taxable year.

CROSS REFERENCE: None

TOPICAL INDEX: Apportionment/Transportation Companies

MOBIL

Mobil Oil Corp. v. Commissioner of Taxes of Vermont (1980) - 445 US 425, 63 L ED 2d 510, 100 SCt 1223.

Mobil Oil Corporation ("Mobil") had its principal place of business and its commercial domicile in New York. Mobil and its affiliates constituted an integrated petroleum business which did business in over 40 states as well as a number of foreign countries. None of Mobil's affiliates did business in Vermont. In Vermont, Mobil's business activities consisted of wholesale and retail marketing of petroleum and related products.

Mobil's federal net income for 1970, 1971 and 1972 included substantial amounts of dividends received from its foreign affiliates. On its Vermont income tax return, however, the company classified all of the foreign source dividends as non-business income. Vermont reclassified the foreign source dividends as business income.

The US Supreme Court held in favor of Vermont stating that,

* Sufficient nexus existed between Mobil and Vermont to justify an apportioned tax on both appellant's investment income and its operating income.

* Mobil's contention that including the dividends in business income could result in multiple taxation since Mobil's commercial domicile state of New York could tax the dividends as non-business income was without basis. New York did not tax the dividend income as New York non-business income and if it attempted to tax the income as such it would probably fail.

* The fact that the income was foreign source dividends did not mandate special taxation rules. Mobil did not overcome Vermont's position that Mobil and its foreign affiliates were involved in a unitary business relationship, therefore, it is accepted that such a relationship existed. Once a unitary relationship was established between Mobil's activities in Vermont and the foreign affiliates, the dividends could be included in apportionable income.

CROSS REFERENCE: Chapter 28, Chapter 29 and Chapter 35 - Apportionment

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TOPICAL INDEX: Apportionment/Non-business Income/Unitary

MOLINE NATIONAL BANK

Moline National Bank v. Illinois Department of Revenue, Plainfield National Bank v. Illinois Department of Revenue (1983) - 111 Ill App 3d 1086.

The taxpayers in this case purchased federally tax-exempt obligations at a premium. When filing their Illinois income tax returns they reduced the addition modification for interest received from federally tax-exempt obligations by the amortized bond premium. The Department of Revenue contended that the amount of interest which should be added back was the total amount of interest received or accrued from the obligations and that no adjustment was allowable for amortization of bond premium.

The Illinois Appellate Court found in favor of the taxpayers. The Court held that the Illinois Income Tax Act was a tax on net income not gross income. Taxation of the amount a bondholder receives from a bond issuer, without amortization of premium, effectively taxes an amount in excess of the actual income from a bond. The amortized premium does not represent income or interest. It is a return of capital and, therefore, it is outside the scope of the IITA.

CROSS REFERENCE: None

TOPICAL INDEX: Tax-exempt Interest - Amortization

MONTGOMERY WARD LIFE INSURANCE

Montgomery Ward Life Insurance Co. v. Department of Local Government Affairs (1980) - 89 Ill App 3d 292.

The Illinois Department of Local Government Affairs had issued a intangible property tax assessment to Montgomery Ward Life Insurance Company ("Montgomery Ward") for the 1977 tax year. In determining the amount of taxes due, the Department included the Government National Mortgage Association securities ("Ginnie Maes") held by Montgomery Ward in its tax base.

Montgomery Ward disagreed the assessment, stating that:

* Ginnie Maes are obligations of the United States which are exempt from state taxation.

* Even if Ginnie Maes are not exempt, the Department is precluded from including them in the tax base because of its published assessment standards set forth in the Property Tax Manual.

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In 1968, Congress created the Government National Mortgage Association ("GNMA") as a wholly-owned government corporation in an effort to attract private capital into the secondary mortgage market of private housing. GNMA was authorized to create the Mortgage Backed Securities Program. GNMA issued a new type of security known as a Ginnie Mae as part of this program.

As the US Supreme Court held in the case of Smith v. Davis, credit instruments of the United States (which are constitutionally exempt from state taxation) have the following characteristics:

* They are written documents.
* They bear interest.
* They are a binding promise by the United States government to pay specified sums at specified dates.
* They have specific Congressional authorization, which also pledged the full faith and credit of the United States in support of the promise to pay.

The Illinois Appellate Court determined that the Ginnie Maes satisfied all of the above requirements except for the "binding promise by the United States government to pay specified sums at specified dates." The United States had no obligation on the Ginnie Maes unless the issuer first defaulted.

Also, the Ginnie Maes were issued by private issuers and not the government and were not used to secure credit for the government. On the contrary, the purpose of GNMA was to attract private capital so that government credit would not be necessary. Therefore, the Illinois Appellate Court held that Ginnie Maes were not obligations of the United States government.

Montgomery Ward then argued that even if the Ginnie Maes were not exempt from State taxation, Illinois was precluded from including them in the tax base since its Illinois Property Tax Manual had listed them as exempt obligations during the tax years in question. Only several years later was the manual "retroactively" changed.

The Court again disagreed with Montgomery Ward stating that the inclusion of Ginnie Maes in the manual as exempt obligations was in error. The Department is not allowed to expand statutory tax exemptions through regulations. The legislature clearly intended to include only those exemptions which were required by the United States Constitution and granted by statutes enacted by the General Assembly. Since Ginnie Maes have been found to not be obligations of the United States government, the Department MUST include them in the tax base.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: US Interest - GNMA/FNMA

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MOORMAN MANUFACTURING

Moorman Manufacturing Company v. G. D. Bair (1978) – 437 US 267, 57 L ED 2d 197, 98 SCt 2340.

Moorman Manufacturing Company ("Moorman") was an Illinois corporation engaged in the manufacture and sale of animal feeds. Moorman had over 500 salesmen in Iowa and owned 6 warehouses in the State. All of the products sold in Iowa were manufactured in Illinois but were delivered from the Iowa warehouses.

A company's Iowa net income for income tax purposes was computed in two steps. First, interest, dividends, rents and royalties received in connection with business in Iowa was allocated to Iowa and that received in connection with business outside of Iowa was allocated outside of Iowa. Second, income derived from the manufacture and sale of tangible personal property was apportioned to Iowa based on a one-factor formula. The factor used was Sales in Iowa as compared to Sales Everywhere.

Moorman contended that the Iowa one-factor formula resulted in extraterritorial taxation since some of Moorman's Illinois' operations were responsible for some of the profits generated by Iowa sales. Moorman believed that the one-factor Iowa formula taxed income which was out of proportion to the company's activities in the State. Finally, Moorman stated that since Illinois used a three-factor formula and Iowa a one-factor formula, multiple taxation would occur.

The US Supreme Court found in favor of Iowa. The Court held that the assumption that the Illinois activities made some contribution to the profitability of the company's Iowa activities did not render use of an apportionment formula invalid. Also, it is an accepted fact that a formula will occasionally over-reflect or under-reflect income which is attributable to a given state. This is true whether the formula in question is a one-factor formula such as Iowa's or a three-factor formula such as Illinois'. Either formula is acceptable unless it is proven by the facts of the case that the result is distorted. Moorman did not meet this burden of proof.

CROSS REFERENCE: Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment

MT. MANSFIELD TELEVISION

Mt. Mansfield Television Inc. v. US (2nd Cir., 1965) - 342 F2d 994, 65-1 USTC Para. 9270.

Mt. Mansfield Television ("Mansfield") claimed a deduction on its federal income tax return for amounts which it claimed were paid for rent of microwave equipment used in its business. In audit, the IRS disallowed the "rental" expense, claiming that Mansfield was

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actually purchasing the microwave equipment. The IRS allowed a deduction for the portion of the contractual sale payments which related to interest and allowed Mansfield to claim a deduction for depreciation of the equipment.

The US District Court found (and the US Court of Appeals affirmed) that the so-called lease agreement which Mansfield entered into for the microwave equipment was actually a conditional sale. The Court found that the determination of whether the agreement was a lease or a conditional sale depended on the substance of the transaction, not the form. Therefore, the fact that the agreement was termed a "lease agreement" was irrelevant.

The agreement was determined to be a conditional sale since Mansfield (the lessee) agreed to:

* Assume the entire risk of loss and damage to the equipment without impairing its obligation under the lease.

* Pay all insurance costs and taxes associated with the equipment.

* Pay "rent" equal to the price of the equipment plus approximately 4% interest.

* Decide at the termination of the initial lease period whether or not to exercise an option to renew the lease at an annual "rent" of approximately one twelfth of the "rental" payment for the initial period. Mansfield further agreed to pay the costs of removal of the equipment if it chose not to exercise this option.

* Submit a financial statement to the lessor and apply for financing.

CROSS REFERENCE: Chapter 35 - Service Industry

TOPICAL INDEX: Property Factor - Leases

NATIONAL REALTY

National Realty and Investment Company v. Illinois Department of Revenue (1986) - 144 Ill App 3d 541.

National Realty purchased property in Florida in 1967 and sold it for a gain in 1973. National Realty classified the gain as non-business income on its Illinois Income Tax return. The Department reclassified the income as business income. The taxpayer pursued the issue through Administrative Hearing and into the courts.

National Realty purchased the Florida property with the intention of developing condominiums on it. Due to zoning restrictions, the taxpayer did not develop the condominiums nor did it make any improvements to the property prior to its sale in 1973.

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National Realty argued that it was not in the business of selling unimproved real estate and that it never used the property in its trade or business.

The Illinois Appellate Court found that the burden of proof was on the taxpayer to show that the income was non-business in nature. The taxpayer did not provide sufficient information to prove what its business activities were or to show that the land was never used in the trade or business. Since the business activities appeared, from the information that was submitted, to be varied and diverse, the income was determined to be business in nature.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Non-business Income

NEBRASKA DEPARTMENT OF REVENUE

Nebraska Department of Revenue v. John Lowenstein, U.S. Supreme Court December 12, 1994.

In a unanimous decision, the U.S. Supreme Court held that Nebraska's income tax on interest that a taxpayer received from owning shares in mutual funds that entered into repurchase agreements involving federal obligations was a valid tax on interest derived from loans rather than a tax on interest from the obligations themselves. The taxpayer owned shares in two mutual funds that earned interest income from repurchase agreements at a rate that was not related to the interest rate on the underlying federal obligations. The Court avoided characterizing repurchasing agreements as a "sale" and "repurchase" of federal obligations and explained that a repurchase agreement constituted a two-part transaction between a party who held federal obligations and sought cash and a party who had cash and sought to earn interest.

The taxpayer argued that the express characterization in the repurchase agreements of the first part of the transaction as a "sale" and the second part as a "repurchase" should control because the characterization was made for business and regulatory reasons that were not related to tax considerations. The taxpayer cited a 1978 U.S. Supreme Court case as the basis for their argument. However, the Court rejected this argument because the substance and economic realities of the repurchase agreements were such that the mutual funds received interest on cash they loaned rather than coupon or discount interest from the obligations.

The taxpayer also argued that Nebraska's income tax scheme did not allow the seller-borrower to attain the full amount of the federal exemption for the interest that the seller-borrower received from the federal obligations themselves and this frustrated the purpose of the exemption. However, the Court rejected this argument as irrelevant to the case.

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The Court held that Nebraska's income tax on interest from repurchase agreements did not violate the Supremacy Clause of the U.S. Constitution. The Court found that the tax did not impair the market in federal obligations or the borrowing ability of the Federal Government. They reversed the decision of the Nebraska Supreme Court and remanded the case back to the lower court.

CROSS REFERENCE:

TOPICAL INDEX:

NEW YORKER MAGAZINE

New Yorker Magazine, Inc. v. Department of Revenue of Illinois (1989) - 187 Ill App 3d 931.

New Yorker Magazine, Inc. was a unitary business whose primary business activity was the publishing of The New Yorker magazine. It derived its revenues from subscriptions, newsstand sales and advertising.

New Yorker was audited for the years 1975-1981. In audit, New Yorker's sales factor was increased due to the inclusion of:

* Advertising income (based on destination of the magazines in which the advertising was included), and

* Subscription and newsstand sales that were shipped from a printer in Illinois to jurisdictions in which New Yorker was not taxable. (This adjustment was made through September 8, 1979 only due to an amendment to the IITA.)

New Yorker argued that the advertising income was intangible and, therefore, should be included in the numerator of the sales factor of the state in which the majority of the income producing activity took place. The Department took the position that the advertising became a part of the tangible personal property being sold, therefore, the destination sale and throwback provisions should apply.

The Illinois Appellate Court found that the advertising space being sold was an integral part of the publication and sale of the magazine. It was not a service being performed separate and apart from the magazine sales. Therefore, the Department was correct in including advertising income in the numerator of the sales factor based on the sales of tangible personal property rules.

New Yorker also argued that the subscription and newsstand sales that were shipped from the printer to jurisdictions in which New Yorker was not taxable should not be thrown back to Illinois because the 1979 amendment was a clarification of rather than a change to existing law, and the printer should not be considered a place of shipment in Illinois.

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The Appellate Court found that the legislative history of the amendment referred to the change as a creation of an "exemption" for independent printing plants. Therefore, the amendment was a change to existing law. Secondly, the Court found that New Yorker entered into a contract with the printer to not only print but also to distribute the magazine. New Yorker determined the quantity to be shipped and had continuing responsibilities relating to the shipments.

CROSS REFERENCE: Chapter 35 - Advertising Revenues

TOPICAL INDEX: Sales Factor - Advertising Revenues

NORFOLK & WESTERN

Norfolk & Western Railway Company v. State of North Carolina ex rel. Maxwell (1936) - 297 US 682, 50 SCt 625.

Norfolk & Western Railway Company ("N & W') had railway lines in North Carolina, Virginia, Maryland, West Virginia, Kentucky and Ohio. Its lines in North Carolina were branches connecting with main lines in the other states.

For North Carolina income tax purposes, the net income of interstate railway companies attributable to the State was determined as follows:

"...net income within this State shall be ascertained by taking their gross operating revenues within this State, including in their gross operating revenues within this State, the equal mileage proportion within this State of their interstate business, and deducting from their gross operating revenues, the proportionate average of operating expenses or operating ratio for their whole business, as shown by the [ICC] standard classification of accounts."

N & W argued that the North Carolina formula was unfair. The company believed that using an average based on mileage within the State created a grossly inaccurate result since operating expenses were much greater in North Carolina (due in part the mountainous terrain) than they were in other parts of railway lines.

The US Supreme Court disagreed. First, the Court found that use of a formula to compute the amount of net income which was subject to a State's income tax was acceptable. Second, the Court held that the use of mileage ratios in the formulas was also acceptable. "...mileage may have at times a relation to a tax upon net income which it may not bear to a property tax or even to one upon the values of a franchise...the statute is the outcome of a reasonable endeavor to arrive at a proportion of general validity."

However, the Court further found that a formula which is acceptable on its face may be unworkable or unfair when applied to a certain set of facts. N & W had argued that the

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GROSS EXPENSES related to the North Carolina lines were greatly in excess of those arrived at using the statutory formula, therefore, North Carolina net income was distorted. The company had several experts testify that the actual expenses in North Carolina were much greater that the formula ratio. However, at that point the company stopped and no figures showing the actual distortion were provided.

On the other hand, North Carolina rebutted N & W's contentions that the result was unfair by providing "elaborate studies and analyses" to show that the GROSS INCOME arrived at by use of the formula was actually much less than the actual gross income which could be directly attributed to North Carolina lines.

The Court again found in favor of the State,

"A finding that the statute, though fair upon its face, is oppressive toward the railway in its practical operation cannot rest upon so fragmentary and partial a showing of facts. We must bear in mind steadily that the burden is on the taxpayer to make oppression manifest by clear and cogent evidence."

CROSS REFERENCE: None

TOPICAL INDEX: Apportionment/Transportation Companies

NORTH AMERICAN CEMENT

North American Cement v. Grover (NY, 1936), 199 NE 510.

North American Cement operated three cement plants and one lime plant. The corporation operated all four plants separately, sold their products in separate geographic areas, and kept separate accounts. Very little of taxpayer's products were sold from other states into New York. New York used a one-factor formula (property) to apportion the taxpayer's income; whereas the corporation argued that allocation by means of separate accounting resulted in much less income in New York for one year and a loss in each of the other years.

The court held that the operations of the four separate manufacturing plants were so interrelated that it was proper to treat the entire operation as unitary. It also found that separate accounting in accordance with recognized accounting practice is insufficient evidence to disprove the propriety and presumption of fairness of formula allocation.

CROSS REFERENCE: Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment

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NORTHWESTERN STATES PORTLAND CEMENT CO.

Northwestern States Portland Cement Co. v. Minnesota (1959) - 358 US 450.

Northwestern States Portland Cement Company ("Northwestern") was an Iowa corporation engaged in the manufacture and sale of cement. The company maintained a leased sales office in Minnesota where a "District Manager", one other salesman and a secretary worked. Two additional salesmen used the office as a clearinghouse. The company also furnished two cars for use by the Minnesota salesmen.

The Minnesota salesmen solicited sales from customers whose names appeared on an eligible list of dealers. The list was provided by the company. The salesmen were authorized to quote the customers "delivered prices", however, all of the product prices were set by the company at its Iowa headquarters. All Minnesota orders were accepted, filled and shipped from its Iowa plant.

In addition to soliciting orders from eligible dealers, the Minnesota salesmen also contacted potential customers. Orders were solicited from the potential customers and transmitted to a local dealer who appeared on the company's list. The new customer's order would be accepted and filled by the local dealer who, in turn, obtained the products to fill the order from the Minnesota salesmen. Finally, the salesmen would receive and transmit to the company customer claims for loss or damage in any of the shipments, informing the company of the nature of the problem and requesting instructions concerning the claims.

The US Supreme Court held, for the first time, that a state could tax exclusively interstate commerce as long as the tax did not create any effect forbidden by the Commerce Clause. The Court felt that a tax imposed directly on that portion of a non-domiciliary corporation's net income earned from and fairly apportioned to business activities within the taxing state, did not violate the Commerce Clause, even if the corporation's activities were in furtherance of interstate commerce.

The critical distinction made by the Northwestern Court was that a tax that is imposed on the privilege of engaging in interstate commerce would be invalidated by virtue of the Spector Rule (see Spector Motor Service, Inc.); however, a tax that is imposed on the net income from such commerce would be upheld by virtue of Northwestern.

Public Law 86-272 was passed in 1959 as a reaction to this decision.

CROSS REFERENCE: Chapter 36

TOPICAL INDEX: Nexus

PEOPLE V ST. LOUIS

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The People ex rel. Richard S. Wangelin, County Collector v. The City of St. Louis (1937) - 10 NE2d 360, 367 Ill 57.

The case involved a dispute over where the boundary between Illinois and Missouri was located in the Mississippi River. The issue arose due to a property tax assessment which was levied upon the St. Louis Municipal Bridge which spanned the Mississippi River between East St. Louis and St. Louis.

The Illinois Supreme Court determined (based on prior boundary dispute decisions) that the boundary between Illinois and Missouri was located in the middle of the main channel of the Mississippi River. "International law today defines the river boundaries between States by the middle of the main channel, when there is one, and not by the center, halfway between the banks."

CROSS REFERENCE: Chapter 35 - Transportation Companies

TOPICAL INDEX: Transportation Companies

PHOENIX COAL COMPANY, INC.

Phoenix Coal Company, Inc. v. Internal Revenue, U.S court of Appeals No. 182. March 31, 1956

Phoenix Coal Company filed a petition for the review of a decision of the Tax Court. They contended that the Commissioner was barred from assessing the net income reported by the Phoenix Coal Company. They cited the statute that prohibits re-assessment within three years after filing the claim, but that statute applies only to those years for which an actual assessment of deficiency is made. The Commissioner may review the computation of tax of an earlier year. The Phoenix Coal Company reported a net operating loss of income for the 1947 fiscal year.

The Issues:

1. The Phoenix Coal Company petitioned the U.S. Court of Appeals for a review of the actions of the Tax Court. The Commissioner disallowed certain deductions on the 1945 tax return of the Company, and he re-assessed their net income for that year. After the recomputation it was noted that the Coal Company was deficient for the 1946 tax year. The Coal Company claimed that the assessment for 1946 was barred by the statutory provision in section 275(a) of the Internal Revenue Code, but the Court held that the Commissioner was following the proper procedure and did not violate the statute.

2. The Phoenix Coal Company also raised a question in regards to a recovery of $5,000 received in 1948 in settlement of its suit against its former officers and directors for conspiracy to destroy its business. They claimed that this settlement was allocable to an injury of goodwill, but the tax court held that this sum was allocable only to loss profits,

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and hence was ordinary income, not a return of capital. The Court concluded that the petitioner failed to establish evidence supporting their claim of goodwill. It held that the deficiencies were correctly assessed and that the decision of the lower court must be affirmed.

CROSS REFERENCE:

TOPICAL INDEX:

PHILLIPS PETROLEUM COMPANY

Phillips Petroleum Company v. Iowa Department of Revenue. December 22, 1993. Phillips Petroleum was threatened with a hostile takeover and they responded by purchasing a substantial amount of their own outstanding stock. In order to facilitate the purchase, the Corporation sold gas and oil producing assets. The central question in this case is whether the sale of those assets can be taxed by Iowa as business income, even though the transaction did not take place in Iowa.

The Issues:

1. Phillips Petroleum Corporation is a Delaware Corporation domiciled in Oklahoma. In an attempt to stave off the Companies that were in the process of taking over their Corporation, Phillips offered to exchange debt securities with an aggregate face value of $4.5 billion for roughly 40% of its outstanding stock. In order to pay off the newly acquired debt, Phillips undertook a "special asset disposition program". Under this plan Phillips sold approximately $2 billion in assets. The Iowa Department of Revenue asserted that this transaction produced business income, and therefore it was taxable income.

2. The dispute was based on the interpretation of statutory construction. It involves the Iowa code section 422.32(2) (1993). This statute set the parameters of what would qualify as business income. Another issue that became a point for discussion was the unitary business principle. Under this principle the state may tax a portion of income derived elsewhere only if the activities were related to the corporate business activities within the state. The state of Iowa adopted a two tier test to determine what is to be classified as business income under the unitary business principle. They divided the principle into a transactional test and a functional test. Both of these test identified business income, as income arising from the transactions and activities in the regular course of the taxpayer's trade or business. It also classifies income as business income if it arises from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. The Iowa Department of Revenue claimed that the income that the Phillips Corporation received was business income based on the disposition of property and the transactional test, but the Supreme Court of Iowa did not classify the income received as business income and they ruled in favor of Phillips. The case was reversed and Phillips was entitled to an income tax refund.

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CROSS REFERENCE:

TOPICAL INDEX:

POWELL

United States et al. v. Powell et al. (1964) - 64-2 USTC Para. 9858.

The IRS summoned Powell to given testimony and produce records relating to the 1958 and 1959 returns of the William Penn Laundry, of which Powell was President. Powell appeared in court but refused to produce the records. The taxpayer's returns had been previously examined and the three-year statute of limitations barred assessment of additional deficiencies for those years except in cases of fraud, the asserted basis for this summons. Powell contended that before he could be forced to produce the records, the IRS had to indicate some grounds for its belief that fraud had been committed.

The court held that the IRS need not meet any standard of probable cause to obtain enforcement of its summons, either before or after the three-year statute had expired. It had to show that the investigation would be conducted pursuant to a legitimate purpose, and that the administrative steps required by the code had been followed.

The court also made reference to the case of US v. Morton Salt Co., (338 US 632, 642-643) where the court said of the Federal Trade Commission, "It has a power of inquisition, if one chooses to call it that, which is not derived from the judicial function. It is more analogous to the Grand Jury, which does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not." The court felt that while the power of the IRS comes from a different body of statutes, the analogy to the other agency situations is not without force.

CROSS REFERENCE: Chapter 35 - Subpoena

TOPICAL INDEX: Subpoena

PRUDENTIAL INSURANCE COMPANY OF AMERICA

Prudential Insurance Company of America v. State of Illinois (Director of Insurance, State Treasurer, Attorney General). Illinois Appellate Court. August 31, 1990.

The controversy in this case surrounded the interpretation of the application of a privilege tax in reference to income tax liability. The Illinois Department of Revenue appealed the decision of the Circuit Court, which allowed the Prudential Insurance Company to construe an interest assessment as income tax and granted the company a deduction for the

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interest assessment. The Court also ordered a refund of the Company's privilege tax in the amount of the interest paid. The Department appealed the decision and contended that the Circuit Court erred in allowing the interest assessed to be construed as part of Prudential's income tax, which would determine the amount of their privilege tax.

The insurance company, which is domiciled in New Jersey, was authorized to do business in Illinois. As an insurer, the company is required to pay a privilege tax to the Illinois Department of Insurance in addition to corporate income tax payable to the Illinois Department of Revenue. Under the Insurance Code, the net amount of annual privilege tax paid by the insurer is reduced by the amount paid to Illinois as a tax on or measured by net income.(Ill. Rev. State. 1987, ch. 73, par. 1021(2)(b)). After a federal audit, the Prudential Insurance company was assessed additional tax liability for the years 1972 through 1980. In addition to the liability, there was an accrual of interest on the delinquent amount of taxes. The Insurance Company paid the interest expense under protest, claiming that they were entitled to a credit against their privilege tax in the amount of the interest assessment. The Circuit construed the interest payment as payment of income tax, thereby reducing the privilege tax that was owed by the Insurance Company.

The Court of Appeals reversed the decision of the Circuit Court. The Court (Circuit), held that by examining the plain meaning of the language used in the statutes, they were able to determine the obligation of the Insurance Company. The language used in this particular statute stated that the income tax is to be imposed upon money earned or otherwise received by the taxpayer. The Court held that the language of the statute was not ambiguous, and there would be no justifiable reason to search the motives of the legislature to give the statute a different meaning than what the words of the statute indicate. The Court held that the interest computed was not to be construed as part of the income tax payable, therefore it could not be used as a deduction of the privilege tax that was outstanding. Interest is not assessed on or computed by the amount of net income received by the taxpayer. The Court stated that if the Legislature intended that interest on delinquent taxes be deducted from privilege taxes, the legislature would have expressly provided for the deduction. The Court of Appeals reversed the decision of the Circuit Court.

CROSS REFERENCE:

TOPICAL INDEX:

QUALLS V MONTGOMERY WARD (ARK)

R. L. Qualls, Director, Arkansas Department of Finance and Administration v. Montgomery Ward & Company (1979) – 266 Ark 207, 585 SW2d 18.

Montgomery Ward & Company's ("Ward's") principal place of business was in Illinois with its corporate headquarters located in Chicago. The company's business activities in Arkansas consisted of retail outlets, catalog stores and a catalog agency.

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In computing its Arkansas income for income tax purposes, Ward excluded interest income it received on loans made by it to its subsidiary, affiliate, parent and other related corporations. The company classified this income as non-business income which would be allocated to its state of commercial domicile, Illinois. Upon audit, Arkansas reclassified the interest income as business income.

Ward argued that the interest income was non-business in nature since it was not an integral part of its regular trade or business operations (merchandising). There was no activity in Arkansas relating to the loans and advances from which the interest was derived since the financial department of the office of Ward's treasurer in Chicago was the only department of the company involved. There was no evidence that any of the affiliates to which the loans were made did any business in Arkansas. Most of the affiliates appeared to be part of a unitary business operation with Ward, however, some did not.

The Arkansas Supreme Court held that the interest income was business income. The loans and advances were made to meet the cash needs of the affiliates for corporate purposes. Since many of the affiliates operated at a loss, the loans and advances kept the companies "afloat". Ward was obviously interested in the well-being of its affiliates. If the companies which supplied Ward with its merchandise went bankrupt, Ward would have to find new suppliers. If the real estate companies which held title to the buildings used by Ward went out of business, Ward's business would be hurt.

The Court also found that the funds for the loans and advances came from Ward's working capital account. No effort was made to segregate the funds which were received from sales in a particular state and funds received on investments or from the loans and advances. Rather, all of the income was placed in a general working capital fund to be used for Ward's general corporate purchases or for more loans or investments. The loans and advances were made regularly and consistently throughout the audit period.

"The fact that Ward's regular trade or business operations do not include money lending is of no significance. Obviously, the lending of money to Ward's related corporations consists of transactions and constitutes an activity in the regular course of Ward's business. We cannot view these loans and advances as a mere temporary investment of idle cash, as Ward would have us do. Even if they were, any short term investment of these funds pending their eventual
use in the course of Ward's regular business operations might well be apportionable."

"It seems to us that Ward's purpose and intent in making the loans and advances were to assure financial stability and continued operation of its corporate relatives, most of whom are suppliers of Ward or furnishers of services. Some of these borrowers who are operating at a loss probably would be hard pressed to obtain loans from other sources. Keeping these corporations "afloat" is beneficial to Ward's regular business.."

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Finally, the Court stated that whether or not Ward and its affiliates were involved in a unitary relationship did not control in the determination of whether or not the income received was business or non-business in nature.

"The combined reporting provision and the business income definition serve different purposes, ask different questions and apply different standards. The answer to one does not necessarily imply the same answer to the other."

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Non-business Income

ROCKFORD LIFE INSURANCE COMPANY

Rockford Life Insurance Company v. Illinois Department of Revenue et al. (1986) - 112 Ill 2d 174.

Rockford Life Insurance Company ("Rockford") challenged a 1978 Illinois property tax assessment which included the value of Ginnie Maes held by the company in the tax base. Rockford argued that the Ginnie Maes were obligations of the federal government and were, therefore, immune from state taxation. Also the company contended that the Department could not now include the obligations since it had not included Ginnie Maes in the calculation of capital stock in earlier years and Rockford had relied on that practice in planning its investments.

The Government National Mortgage Association ("GNMA") was established to attract private capital into housing. The mortgage-backed securities program was established. In this program, GNMA was authorized to issue securities backed by a pool of mortgages guaranteed by one of several government agencies. GNMA could also authorize private parties to issue such securities. Finally, GNMA was authorized to guarantee the timely payment of principal and interest of the securities with the full faith and credit of the United States.

The Illinois Supreme Court held that the Ginnie Maes were not immune from State taxation. The obligations did not meet the four-part test for federal obligations:

* Written documents.
* Bearing of interest.
* Binding promise by the United States to pay specified sums at specified dates.
* Specific Congressional authorization, which also pledged the full faith and credit of the United States in support of the promise to pay.

The Court did not believe that Ginnie Maes met the third part of the test, a binding promise by THE UNITED STATES to pay specified sums at specified dates. The federal government merely guaranteed the holder would receive principal and interest payments.

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The actual obligation of the federal government only existed when, and if, the issuer defaulted on the obligation. Also, the securities did not appear to be related to the government's credit needs. Finally, Congress did not authorize the exemption of the obligations. It provided only for the exemption of the Government National Mortgage Association itself.

The Court also dismissed Rockford's second contention, that the Department was stopped from including Ginnie Maes in the tax base due to the prior practice of not including them. The Court held that the company's reliance on the Department's prior practice was not reasonable and that no fraud or injustice had occurred.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: US Interest - GNMA/FNMA

ROPER CORPORATION

Roper Corporation v. Illinois Department of Revenue. Income Tax Hearing Division. 12/20/94

ISSUES:

1. Whether a dividend paid to Roper Corporation as part of its reorganization and sale by GE is business or non-business income?

In April, 1988 two GE subsidiaries purchased the outstanding stock of Roper Corporation. At the time of the purchase Roper included two divisions in its corporate structure; home appliances and outdoor yard products. GE wished to retain the home appliance unit, but they decided to sell the outdoor yard products unit. In order to facilitate the sale of the outdoor yard products unit, Roper transferred its appliance business to RGE, a separate Corporation. In a second transaction RGE sold its stock to another GE company, General Electric Holdings. In exchange for the stock Roper received $282 million in cash. According to the attribution rule, Roper was treated as owing more than 50% of the stock of both RGE and GE Holdings. The combination of the attribution and the redemption rules of IRC 302 resulted in Roper treating the cash payment as a dividend.

2. The Department of Revenue treated the cumulative effect of all of the business transactions as a sale of the business and as treated the dividend as business income. The Department also made the claim that the dividend was a dividend from a unitary concern. The Roper Corporation asserted that their business was not of unitary concern because the lawnmower business was separate and distinct from the home appliance business. They were willing to settle out of court in a settlement of 55% of the tax deficiency. The Department agreed to the settlement citing the hazards of litigation and the issue is a non-recurring issue, they believed that this settlement was in the best interest of the Department.

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SEARLE PHARMACEUTICALS

Searle Pharmaceuticals, Inc. v. The Department of Revenue and Caterpillar Tractor Co. et al. v. J. Thomas Johnson (1987) - 117 Ill 2d 454.

This case involved various challenges to a 1977 amendment to Section 203(e)(2)(E) of the IITA which provided that any corporation which was a member of an affiliated group of corporations filing a consolidated federal income tax return, incurring a net operating loss on a separate Illinois income tax return basis, be deemed to have made the election provided in Section 172 of the IRC, that is, to relinquish the entire carryback period and only carry forward the loss. Taxpayers filing separate federal returns were allowed to carry their losses either back or forward in the same manner as they did federally.

The Illinois Supreme Court found that the 1977 amendment violated the uniformity clause of the Illinois Constitution. The Court determined that there is no real and substantial difference between a corporation which is a member of an affiliated corporate group that elects to file a federal consolidated return and a corporation which is a member of an affiliated corporate group which does not elect to file a consolidated federal return. Therefore, to distinguish between these two types of taxpayers would be unconstitutional.

CROSS REFERENCE: Chapter 33 and Chapter 41

TOPICAL INDEX: Net Operating Losses/Statute Of Limitations

SHAFFER

Shaffer v. Carter (Oklahoma, 1920) - 252 US 37.

Charles B. Shaffer was a resident of Illinois during the years in question. Mr. Shaffer had purchased, owned, developed and operated a number of oil and gas mining leases in Oklahoma. Oklahoma assessed an income tax liability against Mr. Shaffer based on the income generated from his business activities in that State. Mr. Shaffer refused to pay the assessment and, as a result, a lien was placed on his Oklahoma property.

Mr. Shaffer contested the assessment on two grounds. First, he believed that attempting to subject nonresidents of a state to a state income tax violated an individual's constitutional rights. Second, he argued that (if the law was valid) placing a lien on ALL of his Oklahoma property was also unconstitutional and the State could only place a lien on the specific property whose income generated the assessment.

The US Supreme Court found in favor of Oklahoma on the first issue by stating that a state has complete dominion over all persons, property and business within the state. As such, the state also has the duty to preserve and protect all such persons, property and

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business within the state. In order to defray the costs of these duties, the states have the right to resort to any reasonable form of taxation.

"Property has a value chiefly for what it is capable of producing...That the state, from whose laws property and business and industry derive the protection and security without which production and gainful occupation would be impossible, is debarred from exacting a share of those gains in the form of income taxes for the support of the government, is a proposition so wholly inconsistent with fundamental principles as to be refuted by its mere statement. That it may tax the land but not the crop, the tree but not the fruit, the mine or well but not the product, the business but not the profit derived from it is wholly inadmissible."

The US Supreme Court also found in favor of Oklahoma on the second issue. The Court stated that the state could not place a lien for an income tax upon a nonresident's unproductive property nor upon any particular productive property beyond the amount of the tax upon the income that has proceeded from it. However, in this case, all of Mr. Shaffer's property in Oklahoma was part of his oil-producing business.

The income being taxed was based on all of the oil-producing business performed within the state and, therefore, the state was justified in placing a lien on ALL of Mr. Shaffer's property within the state.

CROSS REFERENCE: Chapter 36

TOPICAL INDEX: Individuals - Nonresidents

SHELL OIL COMPANY (FLORIDA)

Shell Oil Company vs. Department of Revenue, State of Florida (1986) - 496 So 2d 789.

NOTE: See also Shell Oil Company v. Iowa Department of Revenue for a US Supreme Court decision on the Outer Continental Shelf issue.

The Supreme Court of Florida consolidated two applications for review of the decision of the District Court of Appeal. Shell Oil Company asked for review of the Appellate Court decision which found that the State of Florida was NOT prohibited by USC Section 1333(a)(2)(A) from imposing a tax upon income derived from the sale in the United States of oil extracted from the Outer Continental Shelf. The State of Florida requested review of the Appellate Court's decision that Shell Oil had the right to include Intangible Drilling Costs in the property factor even though they had elected to expense the costs federally.

Shell Oil Company ("Shell") conducted business throughout the United States. Among its many activities, Shell operated a number of drilling platforms for the extraction of crude oil and natural gas from the outer continental shelf ("OCS"). Shell made all transfers of OCS natural gas by sale to nonaffiliated independent pipeline companies that rented space on

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Shell's platforms. Shell made some transfers of OCS crude oil by sale to independent third parties, but Shell transported most of the crude oil through its own pipeline to shore. Shell treated all transfers (whether to third parties or to its own pipeline) as taxable sales occurring at the OCS platforms for federal income tax purposes. For Florida income tax purposes, Shell eliminated the profits from the transfer from taxable income.

Both parties agreed that 43 U.S.C. Section 1333(a) (1970) states that taxation laws shall not apply to the outer continental shelf. Both parties also agreed that, based on this section of the Outer Continental Shelf Land Act, the sales which actually occurred on the OCS oil platforms should be excluded from the computation of Florida taxable income. However, Shell contended that Florida had no right to include ANY of the income from sales of oil which was DERIVED from OCS platforms. Florida on the other hand argued that because Shell actually sold the oil within the boundaries of the 50 states and not ON THE OCS PLATFORMS, the taxable event occurred within the reach of Florida's tax laws and the income should be included in the computation of Florida taxable income.

The Florida Supreme Court found in favor of the state, upholding the Appellate Court's decision. "Although Section 1333(a)(3) prevents states from claiming an interest in or jurisdiction over the revenues derived from OCS natural resources, the language of this subsection when read in conjunction with the rest of Section 1333(a) simply constitutes a limitation of state authority over the OCS area and does not seem intended to address income derived outside the OCS."

The Court believed that the sales occurred when the taxpayer received actual economic gain from the disposition of property. No realization of income occurred at the wellhead, despite Shell's assignment of an artificial wellhead price to the oil, because Shell received no actual economic gain from any sale at that point. Rather, realization occurred at the time Shell sold the oil in the states because only at that time did Shell derive any actual economic gain. The income was, therefore, derived outside the OCS and within the reach of Florida's tax laws.

The Florida Supreme Court reversed the Appellate Court's decision regarding the Intangible Drilling Cost issue stating:

"We find...that the district court erred in ruling that expensed IDSs should be added back into Shell's asset base when calculating the property factor of the apportionment formula. IDCs are not inherently capital in nature. Under federal law, Shell had the option of either capitalizing or expensing its IDCs...Shell elected to expense them for federal income tax purposes, thereby deducting the IDCs from its taxable income base...Florida...requires that a taxpayer's method of accounting for purposes of the Florida Income Tax Code be the same as the taxpayer's method of accounting used for federal income tax purposes.

IDCs occupy a special tax category, offering an incentive to oil and gas exploration and production...Care must be taken, however, not to extend the obvious benefits of this special treatment beyond its intended boundaries."

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CROSS REFERENCE: Chapter 29 and Chapter 35 - Oil and Gas Companies

TOPICAL INDEX: Apportionment/Oil and Gas Companies/Property Factor - Intangible Drilling Costs

SHELL OIL COMPANY (IOWA)

Shell Oil Company v. Iowa Department of Revenue (1988) - 488 US 278.

The facts of this case mirror the Shell Oil Company (Florida) case. Shell sold all of its natural gas extracted from Outer Continental Shelf (OCS) lands to third parties at the wellhead platform. Most of the crude oil extracted from OCS lands however was transported through Shell's own pipeline inland, where it was either sold to third parties or refined.

Again Shell relied upon 43 U.S.C. Section 1331 which provides in part that "State taxation laws shall not apply to the Outer Continental Shelf." Shell argued that this language expressly prohibited state taxation of any income from OCS activities. In this case however, Iowa sought to include income from the ALL of the OCS-related sales (those that occurred at the OCS platforms and within the 50 states) and it also included the revenues in the Iowa single factor apportionment formula.

The US Supreme Court found in favor of Iowa. The Court noted that historically the controversy between the federal government and adjacent states had centered on the ability of the states to levy production and other direct taxes on OCS production. This type of taxation was, therefore, the focus of the Outer Continental Shelf Land Act, not to prevent taxation of OCS-related income.

The Court also rejected Shell's contention that even if the Outer Continental Shelf Land Act allows states to include OCS-related income from sales which occurred outside of the OCS, the statute prohibits the inclusion of income derived from "on-Shelf" sales. The Court said,

"Shell's argument hinges on the mistaken premise that including OCS-derived income in the reapportionment tax base is tantamount to the direct taxation of OCS production...the inclusion of income in the reapportioned tax base of a state apportionment formula does not amount to extraterritorial taxation...This Court has repeatedly emphasized that the function of an apportionment formula is to determine the portion of a unitary business' income that can be fairly attributed to instate activities."

In summary, the US Supreme Court held that all OCS-related income could be included in the reapportioned tax base in computing a person's state tax liability and as appropriate in the apportionment formula.

CROSS REFERENCE: Chapter 29 and Chapter 35 - Oil and Gas Companies

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SHELL OIL COMPANY (ILLINOIS)

Shell Oil Company, et al v. Illinois Department of Revenue (1993) - Circuit Court of Cook County, Docket Number 91 L 50905.

On its Illinois income tax returns for 1981 through 1984, Shell computed its property factor by including intangible drilling costs (IDCs) which it had elected to expense on its federal income tax returns. In audit, Illinois disallowed the inclusion of the federally expensed IDCs in the property factor.

Shell argued that the IDCs were part of the "original cost of constructing an oil or gas well" and were, therefore, included in the property factor whether they were expensed or capitalized federally. Illinois contended that only IDCs which were capitalized federally became a part of the "original cost" of the wells, therefore, only capitalized IDCs could be included in the property factor.

The Circuit Court of Cook County found in favor of Shell, holding that IDCs should be included in the property factor whether they were expensed or capitalized for federal income tax purposes. Since there were no Illinois rulings nor had Illinois adopted regulations regarding the treatment of IDCs, the court relied heavily on how other states with statutes similar to Illinois have treated IDCs and how Illinois courts have ruled on similar issues.

The court put tremendous weight on a recent amendment to the MTC Regulations which states that "...development costs shall be included in the property factor whether or not they have been expensed for either federal or state tax purposes." Although Illinois ceased being a member of the MTC in 1975, the court believed that MTC's rule on this issue affected Illinois since the "principles [of the MTC] are still embodied in the apportionment formula." In fact, Section 100.3550(c) of the Ill. Admin. Code states,

If the returns or reports under Article IV of the Multistate Tax Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the valuation of property and in the exclusion or inclusion of property in the property factor, the person shall disclose in its return to the state the nature and extent of the variance.

The circuit court felt that since,

"...the Illinois taxpayer must be consistent in excluding or including property in the property factor with the MTC states and...MTC Regulation IV.11(a) REQUIRES that IDCs be included in the property factor regardless of whether the IDCs were expensed for federal income tax purposes...Illinois should follow the decisions of the other states that have addressed the issue...and the MTC."

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The court also felt that the 1986 Oregon Supreme Court decision in the case of Atlantic Richfield Company v. Department of Revenue was significant. The situation in Atlantic Richfield was similar to this case in that Oregon had not adopted any rules or statutes on the IDC issue. The Oregon Supreme Court held in that case that, in order to achieve uniformity among the taxing states, IDCs should be included in "original cost" of the property factor regardless of their federal treatment.

Finally, the court did not agree with Illinois' reliance on the 1986 decision in the case of Shell Oil Company v. Department of Revenue, State of Florida in which the Florida Supreme Court ruled that a taxpayer's method of accounting for federal purposes should be followed for state taxation purposes. In that case, the Court held that IDCs are not inherently capital in nature and if a taxpayer elected to expense them federally, they should not be included in the property factor as part of the "original cost" of the wells. The Circuit Court of Cook County determined that the Florida court's "application of the method of accounting requirement [was] mistaken."

CROSS REFERENCE: Chapter 29 and Chapter 35 - Oil and Gas Companies

TOPICAL INDEX: Apportionment/Oil and Gas Companies/Property Factor - Intangible Drilling Costs

SMITH V DAVIS

Smith et al. v. Davis et al. (1944) - 323 US 111, 65 SCt 157.

In this case the four-part test was developed for determining whether or not an obligation was a "credit instrumentality of the United States" and, therefore, immune from State taxation. The Smith v. Davis decision is referred to in many other Government obligation cases.

E. Jack Smith and several other partners were engaged in the construction and contracting business. At the beginning of 1942 the United States owed them approximately $29,000 under the terms of two contracts with the US Army. The tax officials of Fulton County, Georgia included the money due on the open account with the US Army in the tax base when computing the partnership's property tax liability. The partnership took the case to court arguing that the open account was an obligation of the United States and, therefore, could not be included in the State property tax base.

The US Supreme Court disagreed.

"...a mere open account with the United States differs vitally from the type of credit instrumentality's which this Court in the past has recognized as constitutionally exempt from state and local taxation. Such instrumentality's in each instance have been characterized by (1) written documents, (2) the bearing of interest, (3) a binding promise

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by the United States to pay specified sums at specified dates and (4) specific Congressional authorization, which also pledged the faith and credit of the United States in support of the promise to pay."

CROSS REFERENCE: None

TOPICAL INDEX: US Interest

SMITH, KLINE & FRENCH LABS

Smith, Kline & French Laboratories v. Oregon State Tax Commission (1964) - 403 P2d 375.

Smith, Kline & French Laboratories ("SK&F") was a Pennsylvania corporation with its principal offices in Philadelphia. It manufactured and sold ethical pharmaceutical products in interstate commerce. In Oregon, SK&F had no office, no office equipment, no inventory, no telephone listing, no telephone answering service, no mailing address and no automobile. SK&F did have 5 or 6 resident representatives ("detail men"). SK&F reimbursed these employees for use of their own cars and other expenses and provided them with samples and sales materials.

The representatives visited hospitals, other medical institutions, doctors, retail druggists and wholesalers explaining use and quality of SK&F's products and encouraging their purchase and use. The representatives did not solicit sales (except on rare occasions) but rather promoted the use of SK&F's products. Only state institutions and wholesalers purchased products directly from SK&F.

Oregon believed that SK&F was taxable for state income tax. Oregon contended that PL 86-272 created an "island of immunity" around the solicitation of orders and that solicitation required that an actual order by sought from a potential customer. Since SK&F's employees in Oregon merely encouraged the placing of orders from firms selling SK&F's products, they were not soliciting sales and, therefore, SK&F did not qualify for the exemption.

The Oregon Supreme Court found in favor of SK&F. The Court believed that PL 86-272 not only exempted solicitation activities but also "all lesser, included phases." The Court further stated that, because of the technical nature of SK&F's business, SK&F's employees in Oregon were performing what would be the equivalent of solicitation of orders for less technical businesses.

CROSS REFERENCE: Chapter 36

TOPICAL INDEX: Nexus

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SPECTOR MOTOR SERVICE, INC.

Spector Motor Service, Inc. v. O'Connor (1951) - 340 US 602.

Spector Motor Service, Inc. ("Spector") was a Missouri corporation involved exclusively in interstate trucking. The State of Connecticut felt that Spector was liable for taxes under the Connecticut Corporation Business Tax Act. Spector believed that, since it was engaged exclusively in interstate commerce, the tax was being levied in violation of the Commerce Clause of the US Constitution.

The Connecticut Corporation Business Tax Act stated that "every...corporation or association carrying on business in this state which is required to report to the collector of internal revenue...shall pay, annually, a tax or excise upon its franchise for the privilege of carrying on or doing business within the state..."

The US Supreme Court held that, under the Commerce Clause, a state cannot levy a tax upon the privilege of carrying on a business that is exclusively interstate in character, no matter how fairly the tax is apportioned to business done within the state. Spector's business was the interstate transportation of freight. When a full truckload was to be shipped to or from any customer in Connecticut, Spector's over-the-road trucks went directly to the customer's place of business. In the case of less-than-truckload shipments, pickup trucks operated by Spector gathered the freight from customers for assembly into full truckloads at either of two terminals maintained within the State.

The Commerce Clause clearly indicates that a tax to be levied by states must be nondiscriminatory and not place undue burden on interstate commerce. Although the tax was nondiscriminatory, it placed an undue burden on interstate commerce because Spector engaged in what the court considered to be an "exclusively interstate" business and "exclusively interstate" was not within the realm of the states' borders.

CROSS REFERENCE: Chapter 36

TOPICAL INDEX: Nexus

SPERRY & HUTCHINSON

Sperry & Hutchinson Company v. Oregon Department of Revenue (1974) - 270 OR 329, 527 P2d 729.

The Sperry & Hutchinson Company ("S & H") was incorporated in New Jersey, domiciled in New York and (during the years in question) did business in 48 states including Oregon. S & H's primary business activity in Oregon was the sale of a trading stamp promotional service (S & H Green Stamps). The Green Stamp business produced substantial revenues during the years involved, a large part of which S & H invested in fixed income securities.

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S & H divided its investment portfolio into 3 categories:

* Short-term securities (maturing in less than 12 months) held pending use of the funds in the Green Stamp business.

* Short-term securities held pending acquisition of other companies or favorable developments in the long-term investment market.

* Long-term securities held as an investment.

S & H filed its Oregon income tax returns for 1961, 1963, 1964 and 1965 claiming the interest income from these investments as non-business income allocable to its state of commercial domicile. In audit, Oregon reclassified all of the above interest income as business income for all of the years involved.

The Oregon Supreme Court (affirming the decision of the Tax Court) found that the interest income from the long-term investments and the short-term investments which were held pending favorable conditions in the long-term investment market was non-business income. However, the interest income from the short-term investments which were held to satisfy the need for working capital in the Green Stamp business was business income and should be included in income apportionable to Oregon.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Non-business Income

STANDARD OIL COMPANY OF CALIFORNIA

Appeal of Standard Oil of California, California SBE (1983) -

Standard Oil Company of California ("Standard") was commercially domiciled in San Francisco, California. It was the parent company of an affiliated group of domestic and foreign corporations, all of which were involved in a worldwide unitary petroleum business. Certain aspects of the group's petroleum operations were also performed by affiliated joint venture corporations in which the Standard group owned 50% or less of the controlling stock.

When filing its 1967 California franchise tax return on a worldwide unitary apportionment basis, Standard included in its unitary apportionable income, dividends received from the affiliated joint venture corporations. Standard classified the dividends as business income since, in the company's opinion, the dividends arose in the main course of its unitary petroleum business and was derived from intangibles acquired and managed as an integral part of that business. California disagreed, arguing that the dividends should be

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considered non-business income and allocated to California since dividends are generally received from passive investments in other corporations.

The State Board of Equalization found in favor of Standard. The SBE held that that although the joint venture affiliates did not meet the ownership requirements for inclusion in Standard's unitary group, the joint venture affiliates were an integral part of Standard unitary petroleum business since they provided up to 52% of Standard's worldwide oil and gas supplies during the year in question. Since the stock in the joint venture affiliates was purchased to guarantee a supply of oil for Standard's business operations, dividend income from the stock was integrally related to the business activities and was not a passive investment. Under the functional test for business/non-business income, the dividend income should be considered business income.

CROSS REFERENCE: Chapter 29

TOPICAL INDEX: Non-business Income

STANDARD REGISTER COMPANY

Standard Register Company v. Franchise Tax Board (CA, 1968), 259 Cal App 2d 125, 66 Cal Rptr 803.

Standard Register, an eastern corporation, wanted to expand its operations to the western states where it had previously been unable to market its products successfully, so the corporation acquired a California corporation (Sunset-McKee) and thus formed their Pacific division.

With the acquisition, they were able to issue and sell additional stock, and the money received was used to improve buildings and equipment in the Pacific division. The Pacific division filled orders received from the Eastern division, serviced Eastern's products, enabled Standard to have a complete product line (only the Pacific division manufactured sales books), sold all of Standard's products, relied upon Eastern for product research and development and the recruitment of personnel, and was able to benefit from advertising material.

The vice president in charge of Pacific brought know-how from Eastern plants, conferred with the Eastern officers, asked employees from Dayton to come to Pacific to offer suggestions, and transferred several key employees from the Eastern division. The Eastern division, in their offices, handled service clinics for Pacific's customers, budgets for capital expenditures were established through conferences with Eastern offices, and balance sheets and income statements were sent monthly to Standard's Board of Directors.

Eastern made available a number of administrative services to Pacific and made a direct charge for them and Pacific's officers were included in Standard's bonus plan. Finally,

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when a new system was devised for sales accounting on a computer in Dayton, Pacific was put on the system which saved money, since four of Pacific's employees could be eliminated.

The California Court of Appeals found that although Pacific acted independently of Standard, it was apparent that the financing, general direction and control of Pacific was in the hands of Standard, and that Pacific was operated as a subsidiary of Standard. Although there was little evidence as to cost savings through interdivisional cooperation, it was obvious that the cooperation improved Standard's overall earning and contributed to its net income derived from the entire operations. Therefore, the business was determined to be unitary.

CROSS REFERENCE: Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment/Unitary

SUPERIOR OIL

Superior Oil v. Franchise Tax Board (CA), 60 Cal 2d 406, 386 P2d 33.

Superior Oil produced and sold petroleum and petroleum products in a number of states and foreign countries. Its principal place of business was in Los Angeles, California. Superior was not an integrated oil company, since it did no refining or processing (except on a minor scale). Its crude petroleum was typically sold at the well site to other oil companies. All its crude oil mined in California was sold in California, and all crude oil mined outside the state was sold outside the state. During the year in question Superior also received income from a realty subdivision in California, from gains on the sale of capital assets both within and without California and from dividends on stock investments.

Superior filed its California returns using the separate accounting method for its purely California activities (the real estate subdivision project, gains from the sale of capital assets in the state, and income from dividends). Superior then used an apportionment formula to determine the amount of net income received from its petroleum operations which was attributable to California. California felt that the separate accounting method should also be used to determine the amount of petroleum operations income which should be attributed to California.

The California Supreme Court found that there was unity of ownership, unity of operation and unity of use as well as dependency/contribution between Superior's California operations and its out-of-state operations. The California operation contributed substantially to the out-of-state corporations through:

* Executive policy making
* Administrative control
* Coordination of exploration activities, well production, land acquisitions

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* Training of technical personnel
* Scientific and technical development
* Manufacturing and sales
* Accounting
* Tax return
* Personnel transfers
* Insurance
* Purchasing.

The California operations were also dependent upon the out-of-state operations in that:

* Substantial funds were borrowed on assets located outside of California to finance projects in California.
* Legal counseling was provided by chief counsel in Texas.
* Materials were transferred into California.
* Geophysical technical information was sent to California.
* Skilled personnel transferred into California.
* Technical and other information was supplied to California on a daily basis.

The Court declared that interstate movement of goods is not required for a business to be unitary. The Court stated that the producing well in a particular state, "is the end product of interstate activities..." which were defined as "essential factors such as land acquisition, exploration, technology, testing, availability of equipment and personnel, financing..." and that "Superior's products are thus acquired for the local market only as the result of interstate transactions to no less extent than were Butler Brothers' products made available at its local markets. It was not necessary that Butler Brothers' goods be sold on an interstate basis for the unit rule to apply in that case, and the sale of Superior's products on the local market is likewise not determinative."

CROSS-REFERENCE: Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment/Unitary

TALLEY INDUSTRIES, INC.

State of Arizona v Talley Industries, Inc., (1994) – Arizona Court of Appeals, Division One, Department T, No. 1 CA-TX 92-0013.

Talley Industries Inc. was the parent corporation of twenty-five wholly-owned subsidiaries, with its principal place of business in Maricopa County, Arizona. Talley's main business lines were the manufacture of timepieces and timekeeping instrumentation, importing men's and women's apparel, purchase and sale of commercial property, industrial development, and the manufacture and supply of numerous commercial and high technology products for defense and industrial uses. Of Talley's twenty-five wholly-owned subsidiaries, only ten subsidiaries had property, payroll, or sales in Arizona.

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Talley owned 100 percent of the capital stock of the twenty-five subsidiaries and essentially controlled all of their operations. Talley's tax department prepared federal, state and local income tax returns for each subsidiary. It formulated the accounting, general operating, and personnel policies for all subsidiaries. Talley also borrowed funds, incurred corporate office costs, and acted as banker for its subsidiaries. Talley set salary guidelines, set accounting policy and procedures, selected auditing firms, set insurance requirements and established employee benefit and pension plans for all of the subsidiaries. Any claims against a subsidiary were handled by Talley under its general liability insurance policy. Talley's corporate officers served on each subsidiary's board of directors and supervised the operation of that subsidiary. Talley required its logo to be on all correspondence from the subsidiaries. Talley approved each subsidiary's annual budget. Talley's Information Services Manager reviewed the computer needs of each of the subsidiaries, and proscribed any necessary changes. Talley regularly conducted company-wide training programs and seminars. And, Talley purchased automobiles and computer equipment, negotiated contracts, and reviewed, suggested, or implemented manufacturing processes, new products, market strategies, quality control programs, and customer relations programs for the entire group. In 1983, Talley filed a combined return and apportioned 16.26 percent of its combined net income to Arizona. The Arizona Department of Revenue determined that the net income from Talley Industries Inc. and the ten subsidiaries with Arizona factors (property, payroll or sales in Arizona) was 62.2 percent of the combined net income.

Talley claims that the Talley group is a "Unitary Business" under the traditional definition of that term and is therefore entitled to file a combined return. The traditional definition of a unitary business, as stated by the California Supreme Court, is that a business is unitary if these circumstances are present: "(1) Unity of ownership; (2) Unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) Unity of use of its centralized executive force and general system of operation." Talley claims that given this definition and Talley's factors listed above, Talley qualifies as a unitary business and should be allowed to file a combined Arizona tax return (thereby reducing its Arizona tax liability).

The Arizona Department of Revenue contends that the apportionment of the combined return does not accurately reflect the net income of Talley arising from doing business in Arizona. The pertinent statute (A.R.S. section 43-942 (Supp. 1993)) reads: "In any case of two or more corporations owned or controlled directly or indirectly by the same interests, the department may distribute, apportion or allocate gross income, deductions, credits or allowances between or among such taxpayers, if it determines that such distributions, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such taxpayer. For the purpose of enforcing this section, the department may require the filing of a combined report and such other information as it deems necessary." The Arizona Department of Revenue felt that the combined return was not necessary to correctly reflect the Arizona income of the Talley group.

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This was the first case in which the Arizona Supreme Court considered whether or not to adopt the traditional unitary business analysis (used in most states) or an alternative analysis unique to Arizona.

The court ruled that the principal purpose of the allocation is the proper assignment to Arizona of a taxpayer's fair and accurate share of income or deductions reasonably attributable to Arizona. The court further ruled that, because no substantial interrelationship or interdependence of basic operations existed among the subsidiaries, combined reporting was not necessary for a clear reflection of the taxable income earned by the subsidiaries with Arizona income factors.

The court's opinion stressed that the ultimate purpose of the unitary business rules were to properly reflect the income attributable to Arizona. Allowing a taxpayer to lower their Arizona tax liability by including activities which were conducted in different states would be in direct opposition to the ultimate purpose of the unitary business rules.

The court did not define substantial interrelationship or interdependence of basic operations in the same manner as the courts of other states. Other state have ruled that the mere sharing administrative functions constitutes substantial interrelationship and therefore a unitary business relationship. The Arizona Supreme Court's definition of substantial interrelationship encompasses situations in which the costs associated with both the parent and the subsidiaries are so interrelated that there can be no separate accounting for these costs (i.e. when the parent or subsidiaries sell products to one another). The Arizona Supreme Court thought that the administrative costs in the present case (there were only minimal intercompany sales) can be accounted for separately, therefore no substantial interrelationship or unitary business relationship existed.

TOPICAL INDEX: Unitary

TIPPERARY CORPORATION

Tipperary Corporation v. New Mexico (1979) - 595 P2d 1212.

Tipperary Corporation was originally incorporated in 1967 as Tipperary Land Corporation. At that time it was primarily involved in the agricultural business. In 1969, it acquired a 50% interest in undeveloped mineral acreage in New Mexico and Wyoming. The mineral interests consisted of eighty coal leases in Wyoming and several uranium and sulfur leases in New Mexico. In 1974 Mobil Oil Corporation purchased some of the Wyoming coal leases. Tipperary claimed its portion of the gain on the sale of the leases as non-business income. In audit, New Mexico reclassified the income as business income.

Tipperary Corporation argued that the sale of coal leases was not part of its regular trade or business. New Mexico argued that Tipperary was in the business of exploration and development of oil, gas and minerals and that the sale of the leases was in the regular course of that business. The New Mexico Court of Appeals agreed with the State.

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In a previous decision, the Court had defined the phrase "transactions and activity in the regular course of the taxpayer's trade or business" as including "[b]usiness deals and the performance of a specific function in the normal, typical, customary or accustomed policy or procedure of the taxpayer's trade or business." The Court had also previously concluded that "the nature of the particular transaction", the "former practices" of the corporation, and the use to which the income was put were all pertinent to the determination of whether income was business income. And finally, the Court had previously summarized that,

"...it makes no difference whether the income derives from the main business, the principal business, the occasional business or the subordinate business so long as the income arises from the "regular course" of the business."

The Court found that the gain on the sale of the coal leases was business income. It based this conclusion on the following facts:

* Tipperary's Articles of Incorporation listed as one of its purposes to engage "in the business of owning, holding, buying, selling, leasing and otherwise acquiring and disposing of oil, gas, petroleum and all other mineral properties of every kind, and interests and estates therein..."

* In 1969 Tipperary changed its name to Tipperary Land and Exploration Corporation in order to reflect the acquisition of oil and gas properties and other mineral interests. During this time Tipperary was also involved in mineral exploration. The president of Tipperary was quoted as saying the they were interested in exploring or developing "[a]nything that we might have found that would have had commercial value..."

* From 1969 to 1974, Tipperary was involved in a continued effort to develop and exploit its Wyoming coal acreage and to acquire additional coal acreage.

* After determining that it had neither the expertise nor the capital to develop the coal acreage, Tipperary and its partners contacted at least 33 companies in an effort to sell the leases.

* Tipperary's regular operational, managerial and executive personnel conducted the effort to develop and exploit the coal properties. The expenses incurred in core and water drilling on the property and the lease payments were paid out of general funds.

* Tipperary's management of its coal leases was consistent with the management of certain other properties it owned.

* Tipperary's Annual Reports for 1969 through 1975 contained numerous statements representing its Wyoming coal leases as an integral part of its business endeavors.

CROSS REFERENCE: Chapter 29

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TOPICAL INDEX: Non-business Income

UNDERWOOD TYPEWRITER COMPANY

Underwood Typewriter Company v. Chamberlain (Conn., 1920) - 41 SCt 45, 254 US 113.

The Underwood Typewriter Company ("Underwood") manufactured typewriters and other similar products; sold these products, certain accessories and supplies which it purchased from others; repaired the products; and leased the products. Its main office was in New York however, all of its manufacturing was performed in Connecticut. Underwood operated branch offices in many states which sold, leased and repaired the machines and sold supplies. One of the branch offices was also located in Connecticut.

Connecticut imposed an income tax on Underwood based on its net profits attributable to the State. The amount of Connecticut net profits was computed by multiplying total net profits of the company by an apportionment formula that consisted of a property factor. Underwood contended that the amount of profits attributable to Connecticut should be the profits which arose out of the sales, leasing and repair activities of the Connecticut branch office.

The US Supreme Court found in favor of Connecticut stating that:

"[t]he profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other states. In this it was typical of a large part of the manufacturing business conducted in the state. The Legislature, in attempting to put upon this business its fair share of the burden of taxation, was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the state...There is...nothing in this record to show that the method of apportionment adopted by the state was inherently arbitrary, or that its application to this corporation produced an unreasonable result."

NOTE: This was the first case in which the unitary concept was applied to a mercantile business. It was also the first case in which the US Supreme Court upheld the right of a state to use an apportionment formula to determine the proper amount of INCOME (previous cases dealt with property taxation) attributable to that state, as long as that formula was not arbitrary and did not produce an unreasonable result.

CROSS REFERENCE: Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment

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UNION PACIFIC RAILWAY

Union Pacific Railway Co. v. Ryan (Wyoming, 1885) - 5 SCt 601, 113 US 516.

The Union Pacific Railroad passed through the whole length of the Wyoming territory and, in its course, through the city of Cheyenne. Cheyenne attempted to impose a property tax on the railroad based upon a pro-rata share of all of the railroad's property within the territory. A fraction was used, the numerator of which was the number or miles of track within the city's boundaries and the denominator of which was the number of miles of track within the entire Wyoming territory.

The US Supreme Court upheld the use of a formula by stating,

"The difficulty of assessing the value of railroad property in separate parcels, located in distinct cities and townships, is almost insuperable. A railroad cannot be regarded as mere land, like farm land or building lots; its value depends upon the whole line as a unit, to be used as a thoroughfare and means of transportation. A separate mile or two of its length is almost valueless by itself. And then its rolling stock has no particular locality except a constructive one in the place where the principal office of the railroad company is situated; and it would be manifestly unequal to give to that place the benefit of taxing the whole of it."
CROSS REFERENCE: Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment

UNITED ARTISTS CORPORATION

United Artists Corporation v. Taylor (New York, 1937), 273 NY 334, 7 NE2d 254, affirming 248 app. div. 207, 288 NYS 946.

United Artists Corporation ("United") was headquartered in New York and was in the business of distributing motion picture films to exhibitors (theaters). United was not an agent of the producers but, rather, was an independent contractor. It obtained licenses from producers to distribute and market photoplays to exhibitors within certain territories, and its revenue was derived from the exhibitors.

United contended that the city of New York could not levy a sales tax on the receipts from licenses to exhibit films because such tax violated the Interstate Commerce clause. The New York Court of Appeals stated that the transaction consisted of United transferring to the exhibitor the possession of tangible property in the form of positive and negative prints of photoplays with the license to use or exhibit them for a specified time. The license to exhibit without the transfer of possession would be valueless. Together they were one transaction and constituted a sale. In so far as the sale originated and consummated in New York, it would be subject to tax.

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CROSS REFERENCE: Chapter 35 - Entertainment Industry.

TOPICAL INDEX: Tangible Property

US STEEL CORPORATION

Multistate Tax Commission (MTC) v. US Steel Corporation (1980) - 434 US 452, 98 SCt 799.

In 1972, US Steel Corporation filed this action on behalf of itself and several other multistate taxpayers threatened with audits by the newly created Multistate Tax Commission. The complaint challenged the constitutionality of the Multistate Tax Compact, sought to have the Compact declared invalid and wanted a permanent injunction barring its operation. The case was ultimately decided by the US Supreme Court.

The Boise Federal Court gave no merit to the constitutionality arguments. It ordered US Steel to make certain committee minutes available to MTC auditors and to make appropriate personnel available for interviews. U.S. Steel indicated that the auditors would be allowed to examine only excerpted minutes. The court issued a more definitive order holding, in part, that:

* The MTC was entitled to conduct a worldwide unitary audit on the taxpayers.

* The MTC had a right to access of information of US Steel and all of its domestic and worldwide subsidiaries.

* The MTC may examine such books and records and personnel as may be relevant to the audit.

* After the MTC had established the general areas of inquiry on which its auditors want to interview personnel of taxpayer's tax department, the taxpayers were ordered to designate which of its personnel would have the information necessary to respond, then were required to make sure the interviews took place.

Only the portion of the case which related to the constitutionality of the Multistate Tax Compact was appealed to the US Supreme Court. The US Supreme Court agreed with the lower court's decision that the Multistate Tax Compact did not violate the US Constitution.

CROSS-REFERENCE: Chapter 35 - Subpoena

TOPICAL INDEX: Subpoena

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WALSH V IDOR

Illinois Department of Revenue v. William J. Walsh (1990) - 196 Ill App 3d 772.

William J. Walsh, individually and as a general partner of the Three Fountains East Development, Ltd. partnership, originally brought this action against the Illinois Department of Revenue. On its Illinois return for 1980 the partnership claimed a "7/1/79" valuation limitation subtraction modification. Since the proper subtraction is a 8/1/69 valuation limitation, the return was "math error" and a notice of the additional amount of tax due was issued. The issue involved in this case is whether the "math error" of the subtraction modification was proper or whether a Notice of Deficiency should have been issued for the proposed liability.

The Illinois Appellate Court reversed a Circuit Court decision and found in favor of the Illinois Department of Revenue. Section 1501(a)(12)(D) of the IITA provides that a "mathematical error" includes "an attempt to claim, exclude, deduct, or improperly report, in a manner directly contrary to the provisions of the Act and regulations thereunder any item of income, exception, deduction, or credit." The Appellate Court held that,

"The literal meaning [of Section 1501(a)(12)(D)] suggests that the supposed mathematical error in question must be so clearly and inarguably contrary to the Act and regulations that it is expressly prohibited as a deduction, exemption, credit, or item of income. If there is reasonable doubt that the Act and regulations clearly prohibit the claimed item, it should not be treated under the mathematical error provisions of the Act and the taxpayer should be accorded the deficiency notice proceedings.

In the pending case, we find that the taxpayer's attempt to use "pre 7-1-79 Appreciation" is, in fact, "directly contrary to the provisions of the Act and regulations thereunder"."

CROSS REFERENCE: Chapter 27 and Chapter 33

TOPICAL INDEX: Math Error/Partnerships/Statute of Limitations/Valuation Limitation

WABASH RAILROAD COMPANY

Wabash Railroad Company v. Illinois Department of Revenue. Circuit Court of Cook County. March 23, 1995.

Wabash Railroad Company filed a petition with the Circuit Court seeking a review of an administrative decision made by the Illinois Department of Revenue. The primary issue in this case centers around the proper formula to be used to apportion the business income of Wabash Railroad Company, in computing its Illinois taxable income for the years ended December 31, 1977 through 1981. Wabash asserted that it should be allowed to use the one-factor "revenue miles" formula prescribed for taxpayers furnishing transportation

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services, but the Department of Revenue contended that Wabash must use the three-factor formula prescribed for general taxpayers.

There were several issues that served as the central focus of this case. The parties agreed with one another concerning the unitary status of Wabash. It was found that Wabash was part of the unitary group consisting of Norfolk & Western Railroad Company. The controversy in the case stemmed from the argument made by Wabash, contending that they were furnishing transportation services, and therefore they should be allowed to use the Revenue Miles formula to ascertain their proper tax liability. The Department of Revenue disagreed with this particular claim and the Court agreed with the Department. The Court held that Wabash did not provide transportation services as defined in the Illinois Tax Act section 304(d), which states that the "transportation of 1 passenger or 1 net ton of freight the distance of 1 mile for a consideration", determines what is to be considered as transportation services. The Court held that Wabash's assertion that they were entitled to use the Revenue Miles formula was unfounded. The mere fact that Wabash was part of a unitary group that furnished transportation services, did not mean that every component of the unitary group was engaged in providing transportation services.

The Court asserted that the argument presented by Wabash in reference to the regulation of their business by the INCC, which is the agency that regulates the common carriers of interstate commerce, was not a convincing argument. The Court found that the structure of the agreement between Wabash and Norfolk allowed the maintenance of separate corporate identities for mutual economic benefit and business purposes. Therefore, a determination of Wabash's income tax liability should be consistent with the structure of that agreement.

Another point of contention in the case surrounded the apportionment formula found in Section 100.3700(a)(4) Appendix A. Wabash contended that the use of this formula by the ALJ violated the Commerce Clause of the U.S. Constitution. Wabash claimed that the use of this apportionment formula would result in more than 100% of their income being subject to the State's taxation. The Court agreed with Wabash.
The Court cited the internal consistency test as the basis for their decision. The test holds that a formula must not result in more than 100% of a multistate enterprise being subjected to tax.
Wabash contends that the last issue in this case, the Department denying relief to Wabash, was against the manifest weight of the evidence. Wabash claimed that the statutory apportionment formula used in this case did not fairly represent the extent of their business activity in the State. They contended that they were entitled to use an alternative apportionment formula. The Court agreed with Wabash. The Court cited alternative allocation as the basis for their decision, which allows for alternative provisions if the allocation and apportionment provisions do not fairly represent the extent of a person's business activity in a state.

CROSS REFERENCE:

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TOPICAL INDEX:

WALT DISNEY PRODUCTIONS (1973)

Walt Disney Productions v. United States - (71-2 USTC Para. 9507), 327 FSupp 189 Affirmed as Modified, (73-2 USTC Para. 9484), 480 F2d 66, Cert. Denied.

Walt Disney Productions ("Disney") was a California corporation. In 1962 the corporation's principal business activities were the production and distribution of motion picture films and the operation of Disneyland.

On its 1962 federal income tax return Disney attempted to claim an investment tax credit on motion picture negatives. The production of a motion picture is a complex process involving story material, talent and production expertise and facilities to create a "motion picture negative". The negative is then used to make positive prints which are rented to exhibitors (theaters) for viewing by the public. The investment tax credit which Disney claimed on its federal return was based on the total costs of production of the motion picture negative.

The IRS disallowed Disney's investment tax credit on the motion picture negatives claiming that:

* The negatives were not tangible personal property.

* If the negatives were found to be tangible personal property, they did not individually have a useful life of eight years or more when placed in service.

* If it was determined that the negatives qualified for the credit, Disney used an erroneous basis for the negatives when computing their credit.

The US District Court found (and the US Court of Appeals affirmed) that the motion picture negatives were tangible personal property.

"The motion picture negatives here certainly are tangible - weighing between 27 and 51 pounds, between 5000 and 11,800 feet in length and capable of being seen and touched. The negatives are physically used in the manufacture of prints which are plaintiff's stock in trade to its consumers. It is this use which establishes the eligibility as tangible personal property."

The District Court also found (and the Court of Appeals also affirmed) that Disney's estimate that each of the motion picture negatives had a useful life of at least eight years was acceptable. Many of the company's productions made prior to 1962 had an earning capacity in excess of eight years.

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"[Disney] is engaged in the business of producing family entertainment. As such the film productions of [the company], unlike many other production companies, are not so-called "dated material", i.e. subject matter with an interest span limited by its contents."

On the final issue the Court of Appeals reversed the District Court's decision. The Court of Appeals found that the basis used to compute the investment tax credit on the motion picture negatives should be the same as the basis used for depreciation.

CROSS REFERENCE: Chapter 35 - Entertainment Industry

TOPICAL INDEX: Tangible Property

WALT DISNEY PRODUCTIONS (1977)

Walt Disney Productions v. United States (74-2 USTC Para. 9623), (76-2 USTC Para. 9606) Affirming and Remanding District Court Decision (77-1 USTC Para. 9398) (As Amended).

The facts of the 1977 case were essentially the same as those of the 1973 case. The 1977 case involved the fiscal years ending September 1963 through 1969. The business activities of Disney were expanding in that many of the motion picture negatives were produced for television and the company was now operating a second theme park, Disney World.

The case involved many of the same issues as the 1973 case,

* Were the negatives tangible personal property?
* Did the negatives have a useful life of 8 eight years of more?
* What basis should be used for the negatives?

The US District Court found in favor of Disney on all counts, following the Court of Appeals decision in the 1973 case. The Court of Appeals affirmed the District Court's decision, however, the Court of Appeals decision provided an in-depth explanation of the procedures, and costs involved, in making a motion picture negative (or master negative). This explanation was used to determine the "costs" of the negative for investment tax credit purposes.

The end product (the exhibition print or film) provides both sound and moving pictures. However, the audio and video portions of the film begin processing separately. The "cut-picture negative" contains only the video portion of the film. The "master sound tape" contains all of the dialogue, music and sound effects. These two items are then collectively referred to as the "master negative". This master negative is durable and the steps necessary to produce "it" do not have to be repeated.

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The pieces of the master negative then go through a number of procedures to ultimately create the exhibition print. The interim products created by these procedures are short lived and can be used to make approximately 100 to 150 exhibition prints. The company must then go back to the master negative and start again.

Disney claimed all of the production costs up to the point at which the master negative was produced for the investment tax credit. These costs included:

* Preparing a script from a story.
* Building sets.
* Hiring and rehearsing talent.
* Editing the original film negatives (video portion).
* Mixing the sound effects, dialogue and music (audio portion).
* Other capitalized cost associated with the creation of the master negative.

CROSS REFERENCE: Chapter 35 - Entertainment Industry

TOPICAL INDEX: Tangible Property

WOOLWORTH V NEW MEXICO

F. W. Woolworth Co. v. Taxation & Revenue Department of New Mexico (1982) - 458 US 354, 73 L ED 2d 819, 102 SCt 3128.

Woolworth's principal place of business and commercial domicile was in New York, but it engaged in chain store retailing throughout the United States. New Mexico income tax laws distinguished between apportionable "business" income and allocated "non-business" income Woolworth reported dividend income from four of its foreign subsidiaries (which also engaged in chain store retailing in foreign countries) as non-business income, none of which was to be allocated to New Mexico. Also, Woolworth classified Foreign Dividend Gross-up as non-business income. In audit, New Mexico reclassified both the foreign dividends and the Gross-up amounts as business income.

The US Supreme Court found in favor of Woolworth stating,

"[Woolworth] - as owner of all of the stock in three of its subsidiaries and a majority interest in the fourth - has the potential to operate these companies as integrated divisions of a single unitary business. But the POTENTIAL to operate a company as part of a unitary business is not disposed when, as here, the dividend income from the subsidiaries in fact is derived from unrelated business activity of the subsidiaries, each of which operates a discrete business enterprise.

None of the factors relevant to a State's right to tax dividends from foreign subsidiaries exists in this case. The record shows that [Woolworth's] and its subsidiaries' operations - such as store site selection, advertising, accounting, purchasing, warehousing, and

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personnel training - were not functionally integrated. And except for the type of occasional oversight - with respect to capital structure, major debt and dividends - that any parent gives to an investment in a subsidiary, there was little or no integration of business activities or centralization of management. Thus, the subsidiaries were not a part of a "unitary business"."

CROSS REFERENCE: Chapter 28, Chapter 29 and Chapter 35 - Apportionment

TOPICAL INDEX: Apportionment/Non-business Income/Unitary

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