

IT 18-06
Tax Type: Income Tax
Tax Issue: Statute of Limitations Application

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

THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS

v.

NEAL AND MARY DOE
Taxpayers

Docket # 00-IT-000
Acct ID: XXXXXXXXXX
Letter ID:XXXXXXXXXXXXXXXXXX
Claim for Credit or Refund

RECOMMENDATION FOR DISPOSITION

Appearances: Matthew Crain, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Jason Hardy of Zerbe, Miller, Fingeret, Frank & Jadav for Neal and Mary Doe.

Synopsis:

On May 12, 2016, Neal and Mary Doe (“taxpayers”) filed a Form IL-1040-X, Amended Individual Income Tax Return (“amended return”) for the year 2010 that requested a refund of an overpayment of taxes. The overpayment resulted primarily from an increase in the taxpayers’ distributive share of research and development credits (R & D credits) from an S Corporation. The Department of Revenue (“Department”) issued a Notice of Claim Denial (“Notice”), which denied the taxpayers’ claim for a refund, and the taxpayers timely protested the Notice. The parties filed Motions for Summary Judgment with attached exhibits and agreed that the facts are not in dispute. The

Department contends that the taxpayers' claim for refund must be denied because it was not timely filed pursuant to Section 911 of the Illinois Income Tax Act (35 ILCS 5/101 *et seq.*). The taxpayers contend that they filed the amended return within the time period allowed by statute. After reviewing the Motions and documents, it is recommended that the taxpayers' Motion for Summary Judgment be granted and the Department's Motion for Summary Judgment be denied.

FINDINGS OF FACT:

1. The taxpayers filed a federal amended tax return, Form 1040X, for the year 2010 with the IRS. The reason for the amended return was the receipt of an amended Schedule K-1 from an S Corporation. (Ex. B, pp. 26-27; Ex. E, pp. 2-3)
2. The amended Schedule K-1 is from ABC Mechanical Contractors, Inc. and shows Credits on line 13 of \$XXXXXX. The full amount of the credits is from research expenses. (Ex. B, pp. 4-5)
3. On August 22, 2014, the IRS began an examination of the taxpayers' federal Form 1040X for the year 2010. (Ex. E, p. 2)
4. On February 24, 2016, the IRS issued Form 4549-A, Income Tax Examination Changes, with regard to the taxpayers' 2010 Federal Form 1040. The IRS made adjustments to income relating to the reason for the amended return and changed the taxpayers' taxable income from \$XXXXXX to \$XXXXXX. Line 8b of Form 4549-A shows General Business Credit of \$XXXXXX, which includes the R & D credit of \$XXXXXX. (Ex. B, pp. 4-5; F, p. 1)

5. On May 9, 2016, the IRS closed the examination of the taxpayers' 2010 Federal Form 1040 and reduced the amount of tax by \$XXXXXX. (Ex. E, p. 3; Ex. F, p. 1)
6. On May 12, 2016, the taxpayers filed an Illinois Form IL-1040-X, Amended Individual Income Tax Return, for the year 2010.¹ The amended return requests a refund of an overpayment of taxes in the amount of \$XXXX.. The taxpayers stated the reason for filing the amended return was because they received the amended Schedule K-1. (Ex. B, pp. 1-3)
7. The reason why the taxpayers' Illinois tax decreased by \$XXXX is primarily due to the fact that their R & D credit from Schedule 1299-C increased from \$XXXX on their previously amended return to \$XXXXX on their amended return at issue. It is also partially due to the fact that the taxpayers' expenses related to federal credits or federally tax-exempt income from Schedule M increased from \$XXXXX on their previously amended return to \$XXXXXX on their final amended return.² (Ex. B at 18 line 19, at 17 line 7, at 2 line 19, at 8 line 7)
8. On August 11, 2016, the Department issued a Notice of Claim Denial that denied the taxpayers' claim for refund for the year 2010. The basis for the denial was stated on the Notice as follows: "The Illinois Income Tax Act does not allow us to refund or credit any overpayment from a return filed more than three years after the extended due date if the overpayment is the result of withholding payments, estimated tax payments, or extension payments." (Ex. A, p. 1)

¹ The taxpayers previously filed an amended return with the Department for 2010, but that return is not at issue in this case. (Ex. B p. 17)

CONCLUSIONS OF LAW:

Under section 2-1005(c) of the Code of Civil Procedure, a party is entitled to summary judgment under the following circumstances:

[I]f the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. 735 ILCS 5/2-1005(c).

The purpose of summary judgment is not to try a question of fact, but to determine whether a genuine issue of material fact exists. Gilbert v. Sycamore Municipal Hospital, 156 Ill. 2d 511, 517 (1993). In this case, based on the documents presented and the agreement of the parties, there is no genuine issue as to any material fact. Summary judgment is, therefore, appropriate.

Section 911 of the Illinois Income Tax Act (“Act”) (35 ILCS 5/101 *et seq.*) includes the time period for filing a claim for refund (*i.e.*, amended return) and provides, in relevant part, as follows:

Sec. 911. Limitations on Claims for Refund.

(a) In general. Except as otherwise provided in this Act:

(1) A claim for refund shall be filed not later than 3 years after the date the return was filed ... or one year after the date the tax was paid, whichever is the later; and

(2) No credit or refund shall be allowed or made with respect to the year for which the claim was filed unless such claim is filed within such period.

(b) Federal changes.

(1) In general. In any case where notification of an alteration is required by Section 506(b), a claim for refund may be filed within 2 years after the date on which such notification was due (regardless of whether such

² The difference between the R & D credits of \$XXXX and \$XXXXX is \$XXXX. This leaves \$XXX (\$XXXX minus \$XXXX) of the decrease in tax that is related to the increase in the expenses related to federal credits or federally tax-exempt income from Schedule M.

notice was given), *but the amount recoverable pursuant to a claim filed under this Section shall be limited to the amount of any overpayment resulting under this Act from recomputation of the taxpayer's net income, net loss, or Article 2 credits for the taxable year after giving effect to the item or items reflected in the alteration required to be reported.*

...

(emphasis added; 35 ILCS 5/911(a)(1), (2); (b)(1)).

Section 506(b) concerns changes that affect federal income tax and provides as follows:

(b) Changes affecting federal income tax. A person shall notify the Department if:

(1) the taxable income, any item of income or deduction, the income tax liability, or any tax credit reported in an original or amended federal income tax return of that person for any year or as determined by the Internal Revenue Service or the courts is altered by amendment of such return or as a result of any other recomputation or redetermination of federal taxable income or loss, and such alteration reflects a change or settlement with respect to any item or items, affecting the computation of such person's net income, net loss, or of any credit provided by Article 2 of this Act for any year under this Act, or in the number of personal exemptions allowable to such person under Section 151 of the Internal Revenue Code, . . .

Such notification shall be in the form of an amended return or such other form as the Department may by regulations prescribe, . . . and shall be filed not later than 120 days after such alteration has been agreed to or finally determined for federal income tax purposes or any federal income tax deficiency or refund, tentative carryback adjustment, abatement or credit resulting therefrom has been assessed or paid, whichever shall first occur. 35 ILCS 5/506(b).

The Department argues that the taxpayers' claim was not filed in a timely manner as required under section 911(a). The taxpayers' amended return, which requests a refund in the amount of \$XXXX, was filed on May 12, 2016. The amended return was filed because the taxpayers received an amended K-1, and the refund is primarily due to increases in Illinois R & D credits included on Schedule 1299-C.³ The Department

³ The Department does not contest the small portion of the refund (\$XXX) that is related to the fact that the taxpayers' expenses related to federal credits or federally tax-exempt income from Schedule M increased.

contends that the extension of time allowed under section 506(b) does not apply because the taxpayers' refund request is based solely on state changes related to the R & D credits and not on federal changes. The Department believes that the refund request must, therefore, be denied.

The taxpayers argue that their amended return is not based solely on a state change and is timely under sections 506(b)(1) and 911(b)(1) because it is based on a federal change. On May 9, 2016, the IRS closed the examination of the taxpayers' 2010 federal return based on federal changes, and 3 days later, on May 12, 2016, the taxpayers filed their amended Illinois return for the year 2010. The taxpayers argue that pursuant to sections 506(b)(1) and 911(b)(1), their return was filed within 2 years after the taxpayers were required to notify the Department of the federal change.

The taxpayers admit that the reason their tax decreased by \$XXXX was primarily due to the fact that their R & D credit from Schedule 1299-C increased from \$XXXX to \$XXXXX. (Ex. B at 2, 9, 18, 20) The taxpayers contend that this increase was related to a federal change because it was due to an increase in a distributive share of an R & D credit from an S Corporation. Although the Department contends that this is a state change, the taxpayers note that Illinois law defines the Illinois research credit by reference to the federal credit. See 35 ILCS 5/201(k). Therefore, the taxpayers could not determine their Illinois research credit until the corresponding federal credit had been finalized.

The taxpayers point out that the amended Schedule K-1 shows credits on line 13 of \$XXXXX, which was due to research expenses. (Ex. B, pp. 4-5) The taxpayers contend that the same activities that contributed to the taxpayers' distributive share of the

federal R & D credit also contributed to the taxpayers' distributive share of the Illinois R & D credit. The taxpayers, therefore, state that they could not finally determine their Illinois R & D credit until the IRS accepted the federal credit.

The evidence that the taxpayers have presented is sufficient to support their claim for a refund. Pursuant to section 911(b)(1), the taxpayers are entitled to a refund of an overpayment that results from the recomputation of the taxpayers' net income, net loss, or Illinois credits due to a federal change after giving effect to the item or items in the federal change required to be reported. 35 ILCS 5/911(b)(1). In this case, the taxpayers received an amended Schedule K-1 from an S Corporation. The total R & D credit from this K-1 was \$XXXXXX, which was required to be reported on their federal return. The taxpayers provided a copy of the IRS Form 4549-A, Income Tax Examination Changes, which shows that the IRS made adjustments relating to the reason for the amended return. Line 8b of Form 4549-A shows General Business Credit of \$XXXXXXX, which includes the R & D credit of \$XXXXXX.

Because the R & D credit was required to be reported on the federal return, the taxpayers properly notified the Department of the change as required under section 506(b). The extended limitations period under section 911(b)(1), therefore, applies. Because the taxpayers' refund request is based on the recomputation of the taxpayers' R & D credit and the taxpayers were required to report the R & D credit on their federal return, the taxpayers are entitled to the refund. The refund request is not based solely on state changes.

Recommendation:

For the foregoing reasons, it is recommended that the taxpayers' Motion for Summary Judgment be granted and the Department's Motion for Summary Judgment be denied. The taxpayers are entitled to a refund of \$XXXX.

Linda Olivero
Administrative Law Judge

Enter: July 3, 2018