**IT 15-04**
**Tax Type: Income Tax**
**Tax Issue: Statute of Limitations Application and Propriety of Penalty**

**THE STATE OF ILLINOIS**
**DEPARTMENT OF REVENUE**
**OFFICE OF ADMINISTRATIVE HEARINGS**
**CHICAGO, ILLINOIS**

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| **THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS** v. | **No. XXXX** **Tax Year 2001** |
| **ABC BUSINESS,** **Taxpayer** | **Ted Sherrod** **Administrative Law Judge** |

**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Special Assistant Attorney General Sean Cullinan on behalf of the Illinois Department of Revenue; James Schelli of Webster & Schelli, on behalf of ABC Business.

**Synopsis:**

This matter involves a protest filed by ABC Business ("ABC Business") contesting a Notice of Deficiency ("NOD") issued to this taxpayer by the Illinois Department of Revenue ("Department") regarding ABC Business's Illinois Personal Property Tax Replacement Income Tax liability for the tax year ending December 31, 2001. ABC Business's protest challenges, among other things, the validity of the Department's claim that it's NOD was timely issued. It contends that the Department's assessment was unlawful because it relied upon an unauthorized extension of the statute of limitations on assessments in the absence of which the Department's NOD would have been barred. It also contends that there is no factual basis for the imposition of any penalties in this case.

Hearings regarding this matter were held on November 19, 2014, April 30, 2015 and May 18, 2015 during which the Department submitted documentary evidence. Both the Department and ABC Business have submitted briefs in this matter.[1] After reviewing the evidence of record, I recommend that this matter be resolved in favor of the Department. In support of this recommendation, the following "findings of fact" and "conclusions of law" are made.

**<u>Findings of Fact</u>**

1. The Department's *prima facie* case, including all jurisdictional elements, was established by the admission into evidence of the Department's Notice of Deficiency ("NOD") issued ABC Business on October 10, 2008. Department Exhibit ("Ex.") 1.
2. The Department's NOD assessed a statutory deficiency in the amount of $XXXX. *<u>Id</u>*. The reasons given by the Department for assessing this NOD are enumerated therein as follows:

> We adjusted your Form IL-1120-ST, Small Business Corporation Replacement Tax Return. We increased Part 1A, Line 1, to reflect the taxable income as defined by the Internal Revenue Code and required by Illinois Law. [35 ILCS 5/203(b), (c), (d), (e)]
> We are imposing a failure to disclose participation in a reportable transaction penalty because you did not provide us with a copy of the disclosure that you were required to file with the Internal Revenue Service showing participation in a reportable tax shelter. ...
> We are imposing a reportable transaction understatement penalty because you have a deficiency resulting from a reportable tax shelter transaction. …
> We are imposing a 100 percent interest penalty because you were previously contacted by the Internal Revenue Service or the department regarding the use of a potential tax avoidance transaction and you have a deficiency from that transaction. …
> We are imposing the penalty for failure to register [a] tax shelter or [a] listed transaction and/or failure to properly furnish a list of investors in a potentially abusive tax shelter or listed transaction because you failed to make the proper registration and/or furnish the required list. …
> We are imposing a penalty for promoting tax shelters because you organized (or assisted in the organization [of]) an entity, plan or arrangement, or participated in the sale of an interest in an entity, plan, or arrangement, and in connection with such organization or sale you made (or caused another person to make) a statement as [to] the availability of a tax benefit you knew or had reason to know was materially false or fraudulent. …

[1] ABC Business's brief consists of its Protest, dated December 8, 2008, in response to the Department's Notice of Deficiency.

> We determined that you omitted income in excess of 25 percent of the base income reported on your Illinois Income Tax return. [35 ILCS 5/905(b)]
> We determined that you failed to include on any return or statement for (*sic)* any information with respect to a reportable transaction under Section 501(b) of this Act. [35 ILCS 5/905(b)(2)][2]
> *Id*.

3. All of the adjustments enumerated in the Department's NOD resulted from the Department's reversal of ABC Business's reported Federal taxable income ("base income") reversing a reported loss of $XXXX for FYE 12/31/01 and correcting the amount of ABC Business's base income to $XXXX. Department Ex. 1 (IL-1120-ST Auditor's Report); Taxpayer's Brief p. 3.[3]

**Conclusions of Law:**

In the absence of transactions subject to an extended statute of limitations, the governing statute of limitations for income tax assessments is section 905(a) of the Illinois Income Tax Act ("IITA"), which provides as follows:

> § 905. Limitations on Notices of Deficiency.
> (a) In general. Except as otherwise provided in this Act:
> (1) A notice of deficiency shall be issued not later than 3 years after the date the return was filed, and
> (2) No deficiency shall be assessed or collected with respect to the year for which the return was filed unless such notice is issued within such period.
> 35 **ILCS** 5/905(a)

In the instant case, ABC Business contends that the Department's NOD issued in this case assessing taxes due for the tax year ended 12/31/01, was illegal because it was barred by this statute of limitations provision. In its brief, it states that the 3 year statute of limitations

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[2] As is evident from this finding of fact, the Department's NOD meticulously and thoroughly enumerates the specific reasons for each of the adjustments giving rise to the NOD, including the adjustment to base income resulting from Federal changes to amounts included therein. (See IL-1120-ST Auditor's Report included with the NOD). For this reason I summarily reject ABC Business's claim that the NOD does not comply with section 904(c) of the IITA, 35 **ILCS** 5/904(c) requiring that an NOD "set forth the adjustments giving rise to the proposed assessment and the reasons therefor."

[3] A corporation's "base income" encompasses all of its taxable income properly reportable for Federal income tax purposes. 35 **ILCS** 5/203(b); 5/203(e).

prescribed by section 905(a), noted above, governs the legality of the Department's NOD, and that there is no basis for the Department's application of any other extended statute of limitations prescribed by the IITA. Taxpayer's Brief pp. 2-5.

The record indicates that the Department's NOD was issued on October 10, 2008. Department Ex. 1. ABC Business contends that this date is more than 3 years from the date its 2001 return was filed, which, it claims, was September 15, 2002. Taxpayer's Brief p. 5. If ABC Business's contentions were correct, the Department's NOD would be barred by section 905(a) since it would have been issued more than 3 years after the date on which the ABC Business's return for 2001 was filed.

The record in this case contains no documentary evidence of the date on which ABC Business filed its 2001 return. However, the record does indicate that this return was timely filed since the Department's NOD issued in this case includes no failure to timely file penalties. Department Ex. 1. Accordingly, if ABC Business's return was filed by the extended due date for this return, it would have been filed no later than October 15, 2002. [4]

Contrary to ABC Business's contention, I find that a 6 year statute of limitations, rather than the 3 year statute of limitations prescribed by section 5/905(a) is applicable to ABC Business's 2001 return pursuant to section 5/905(b) of the IITA. Section 5/905(b), provides as follows:

> (b) Omission of more than 25% of income. If the 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, a notice of deficiency may be issued not later than 6 years after the return was filed.
> 35 **ILCS** 5/905(b)

[4] Section 505(b) provides that, if a corporate taxpayer is granted a 6 month extension to file its Federal return, due on March 15, the filing of a copy of such extension will automatically extend the due date of its state return for an equivalent period plus an additional month, to October 15. The record indicates that ABC Business filed its 2001 return after March 15 [purportedly on September 15, 2002] and the NOD indicates no penalties for late filing. From this I deduce that the taxpayer was granted a federal extension and his return was timely filed on or before the extended due date for this return, October 15, 2002.

The record in this case indicates that ABC Business, on its original return, reported as base income, a loss of $XXXX. Department Ex. 1 (IL-1120-ST Auditor's Report). Subsequently, the Department reversed this loss and determined that, in fact, ABC Business's base income (i.e. its properly reportable Federal taxable income) was $XXXX. *Id*. This determination was based on Federal changes to ABC Business's 2001 Federal return.[5] *Id*. Since the omitted amount exceeds 25% of the amount of base income properly includable on ABC Business's return, the extended 6 year statute of limitations prescribed by section 5/905(b), noted above, is applicable in this case. Consequently, I must reject ABC Business's contention that the Department's NOD was barred by the 3 year statute of limitations prescribed by section 905(a) of the IITA.

ABC Business further alleges that, even if an extended 6 year statute of limitations is applicable to its 2001 return, the Department's NOD was still issued beyond the statute of limitations because ABC Business filed its 2001 return on September 15, 2002, and the Department's NOD is dated October 10, 2008. Taxpayer's Brief p. 5. Were this contention correct, the statute of limitations to assess ABC Business on its 2001 return would have expired on September 15, 2008 and the Department's NOD, issued October 10, 2008, would have been time barred.

As previously noted, the record contains no evidence to support ABC Business's claim that its return was filed on September 15, 2002. Pursuant to section 5/904 of the IITA, 35 **ILCS** 5/904, the Department's NOD is *prima facie* correct, and ABC Business's mere allegation that its return was filed more than 6 years before the Department's NOD was issued is insufficient to rebut the *prima facie* correctness of the Department's determination. PPG Industries v. Department of Revenue, 328 Ill. App. 3d 16 (1st Dist. 2002). Moreover, even if PMD Industries

[5] A corporation's "base income" includes its taxable income properly reportable for Federal income tax purposes as determined by the Internal Revenue Service. 35 **ILCS** 5/203(b); 5/203(e); 5/203(h).

could prove that its return was filed on September 15, 2002, this proof would be insufficient to show that the Department's NOD was untimely because section 5/905(h) of the IITA provides as follows:

> (h) Time return deemed filed. For purposes of this Section a tax return filed before the last day prescribed by law (including any extension thereof) shall be deemed to have been filed on such last day.
> 35 **ILCS** 5/905(h)

In accordance with section 5/905(h), the 6 year statute of limitations period prescribed at section 905(b) ran from the extended due date of ABC Business's 2001 return rather than from the date on which this return was allegedly filed. The extended due date of ABC Business's 2001 return was October 15, 2002 pursuant to 35 **ILCS** 5/505(b) noted above. The Department's NOD was issued on October 10, 2008 which is within 6 years of the extended due date of ABC Business's 2001 return. As a consequence of section 5/905(h), the statute of limitations on ABC Business's 2001 return expired on October 15, 2008, which is 6 years from the date this return was due, and did not expire on September 15, 2008 which is six years after this return is purported to have been filed, as ABC Business maintains. In sum, the Department's NOD was timely issued.

ABC Business also contests the imposition of penalties pursuant to 35 **ILCS** 5/1001(b), 35 **ILCS** 5/1005(b), 35 **ILCS** 5/1005(c), 35 **ILCS** 5/1007, 35 **ILCS** 5/1008, 35 **ILCS** 5/1405.5 and 35 **ILCS** 5/1405.6. Taxpayer's Brief pp. 5-9. It claims that the Department has not provided a sufficient factual basis to support the imposition of any of these penalties, and denies that any factual basis for the imposition of penalties under any of these provisions exists.

As the Department points out in its reply brief, ABC Business has provided no evidence to rebut the Department's determination that the penalties at issue have been properly assessed. Section 5/904 of the IITA requires the Department to examine returns and to issue notices of deficiency if it determines additional taxes are due. Specifically, this statutory provision states as follows:

> §904. Deficiencies and Overpayments. (a) Examination of return. As soon as practicable after a return is filed, the Department shall examine it to determine the correct amount of tax. If the Department finds that the amount of tax shown on the return is less than the correct amount, it shall issue a notice of deficiency to the taxpayer which shall set forth the amount of tax and penalties proposed to be assessed. … The findings of the Department shall be prima facie evidence of the correctness of the amount of tax and penalties due.
> 35 **ILCS** 5/904

In the instant case, the Department examined the tax return filed by ABC Business for 2001. At the conclusion of this audit, the Department determined that this taxpayer had engaged in activities related to fraudulent tax shelters that warranted the imposition of penalties pursuant to the aforementioned statutory provisions. Accordingly, it prepared the NOD at issue in this case assessing the penalties to which ABC Business objects.

As is evident from the above, the Department's NOD is deemed to be *prima facie* correct. 35 **ILCS** 5/904(a); Balla v. Department of Revenue, 96 Ill. App. 3d 293, 295 (1st Dist. 1981)("The Illinois legislature, in order to aid the Department in meeting its burden of proof in this respect, has provided that the findings of the Department concerning the correct amount of tax are *prima facie* correct."). At the hearing in this case, the Department established its *prima facie* case by introducing the NOD into evidence. The burden then shifted to ABC Business to overcome the Department's *prima facie* case. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 832 (1st Dist. 1988) ("Once the DOR establishes its prima facie case, the burden shifts to the plaintiff to overcome it by producing competent evidence, identified with its books and records, that the DOR's returns are incorrect."). As noted in PPG Industries, *supra*, 328 Ill. App. 3d at 34: "Further, the law establishes that 'to overcome the Department's prima facie case, a taxpayer must present more than its testimony denying the accuracy of the assessment, but must present sufficient documentary support for its assertions.' " [citation omitted]).

In the instant case, ABC Business's attorney appeared at the hearings in this matter but he did not offer any oral testimony or documentary evidence on behalf of this taxpayer. Accordingly, ABC Business failed to produce any competent evidence identified with its books and records to overcome the Department's *prima facie* correct determination that all of the penalties that have been assessed are due and owing. For the forgoing reasons, I concur in the Department's conclusion noted in its brief stating as follows: "Due to the fact no evidence was presented, the Taxpayer failed to rebut the Department's *prima facie* case and this Tribunal must find in favor of the Department as a matter of law." Department's Brief p. 4.

**WHEREFORE,** for the reasons stated above, I recommend that the Department's Notice of Deficiency at issue be finalized as issued.

Ted Sherrod
Administrative Law Judge

Date: July 20, 2015