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# COMPLIANCE ALERT



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## Compliance Problem

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We have determined that a significant number of recipients of income from pass-through entities (partnerships and subchapter S corporations) are not filing Illinois tax returns and paying tax. In addition, partnerships and subchapter S corporations may not be providing the necessary tax information to their partners and shareholders to allow them to meet their Illinois tax obligations.

## Solution

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- ① Inform your partners and shareholders that they owe Illinois Income Tax on the portion of the pass-through entity income that is apportioned to Illinois.
- ② For nonresident individual partners and shareholders, we recommend that you file Form IL-1023-C, Composite Tax Return, on their behalf to help them avoid penalties, and reduce the number of questions and complaints you receive.
- ③ Review the checklist on Page 2 to minimize problems.

## Background

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We have started a compliance project to determine if partners and shareholders who receive income from partnerships and subchapter S corporations that earn income in Illinois are filing returns in Illinois and paying tax on that income.

Our initial review found widespread noncompliance. The first 300 entities identified more than 5,000 partners and shareholders who did not file Illinois tax returns or pay the proper Illinois tax. We sent them notices and are in the process of billing those who did not respond by filing their returns. Many of these taxpayers did not understand that they had an Illinois tax liability and many others thought that the entity filed a return and paid their taxes.

The level of noncompliance that we have discovered has prompted us to expand our checks of information filed with returns. Accordingly, printouts of Schedule B information, Partner's or Shareholders' Identification, and Form IL-2569, Personal Property Replacement Tax, are no longer acceptable and the information must be submitted on department-approved forms.

Illinois Schedule B and Form IL-2569 must be attached directly to the Form IL-1065 or IL-1120-ST.

For more information on pass-through entity income, see Publication 129, Pass-through Entity Income.

## Did you know?

Partnerships and subchapter S corporations pay Illinois Personal Property Tax Replacement Income Tax (Replacement Tax), while individuals pay standard income tax on Illinois sourced income. This means that both the partnership or S corporation and the partner or shareholder may have an Illinois tax obligation on the same Illinois-sourced income.

## Form and filing changes

Numerous other forms changes have been made, including

- ◆ improvements to Forms IL-1065 and IL-1120-ST,
- ◆ additional information requested for each partner and shareholder on the Illinois Schedule B,
- ◆ additional information requested on Form IL-2569,
- ◆ new amended returns for partnerships and subchapter S corporations,
- ◆ the addition of Schedule BC, Composite Return Membership, to Form IL-1023-C, and
- ◆ rejecting returns that do not include the information we require on department-approved forms

## Checklist for pass-through entities

To ensure proper filing for your company and its partners and shareholders, review the following checklist:

- ✓ If you file Form IL-1023-C on behalf of your nonresident partners or shareholders, you are required to make quarterly estimated payments on Form IL-1023-CES.
- ✓ File Form IL-1023-C and pay any tax liability on behalf of your nonresident individual partners or shareholders.
- ✓ If you file a composite return on behalf of your partners or shareholders, you must complete and submit Illinois Schedule BC, on a department-approved form.
- ✓ For each partner or shareholder who is not included on a Form IL-1023-C composite return, you must complete an Illinois Schedule K-1-P.
- ✓ You must mail Schedule K-1-P and K-1-P(2), Partners' and Shareholders' Instructions, to your partners and shareholders.
- ✓ You must keep a copy of all issued Schedules K-1-P in your files, in the event that your records are reviewed by department personnel. Do not mail them to the department.
- ✓ When you complete your Form IL-1065 or IL-1120-ST, you must complete and submit Schedule B on a department-approved form. Printouts are not acceptable.
- ✓ If you take a subtraction modification for partners or shareholders that are subject to replacement tax, you must complete and submit Form IL-2569 on a department-approved form.
- ✓ Attach all required schedules to your Illinois tax return in the order indicated by the "IL Attachment No." located in the upper right corner of the schedule.