ILLINOIS INDEPENDENT

TAX TRIBUNAL

JOHN E. AND FRANCES L. ROGERS, Petitioners, v. ILLINOIS DEPARTMENT OF REVENUE, Respondent.	))))))))	 14 TT 153 Judge Brian F. Barov

ORDER ON MOTION FOR SUMMARY JUDGMENT, MOTION FOR STAY AND MOTION FOR BOND

The Petitioners are individuals challenging an income tax notice of deficiency issued by the Department for the 2002 tax year. According to the Department, it issued the notice of deficiency after the Petitioners failed to notify the Department of a final federal change to their federal income tax within 120 days of the adjustment, as required by section 506(b) of the Illinois Income Tax Act ("IITA"), 35 ILCS 5/506(b). The Petitioners contend that there was no final federal change to notify the Department of because they have not been afforded all of their federal rights to challenge the merits of the Internal Revenue Service's adjustment to their federal income tax. The Petitioners further claim various errors by the IRS in recalculating their 2002 individual income tax.

There are currently three related motions before the Tribunal. The Petitioners filed a motion to stay the current proceeding, claiming that any adjudication of the Department's notice of deficiency should await the disposition of the case pending before the United States Tax Court in *John E. Rogers & Frances L. Rogers v. Commissioner*, No. 20882-14, in which they claimed to have sought "a hearing on the merits of their 2002 taxes."

The Department objected to the stay motion and filed a motion for summary judgment, in both instances arguing that a final federal assessment was made on May 25, 2011, which is reflected on an IRS account transcript, and that, in any case, in 2008, the Petitioners waived their right to challenge the federal adjustment as a result of a settlement agreement with the IRS. Considering either date, Petitioners did not provide notice of the federal adjustment within the time required by section 506(b) and thus the notice of deficiency was timely issued. Because the notice of deficiency was timely issued, under Illinois law, the Department is entitled to summary judgment and a stay is unwarranted. Further, the Department contended that because the legal issue is so clear, the Petitioners' legal argument is frivolous, and, thus, if a stay is to be granted, the Petitioners should be required to post a bond pursuant to section 1-45(c) of the Illinois Independent Tax Tribunal Act, 35 ILCS 1010/1-45(c) (2014).

As explained below, the Department is entitled to summary judgment on its notice of deficiency's timeliness. The Petitioner's motion to stay these proceedings is denied, as is the Department's motion for the issuance of a bond.

Factual History

This tax dispute dates back to the 2002 tax year. At that time, Petitioner husband, John E. Rogers, held a partnership interest in Abingdon Trading, LLC, an Illinois limited liability company, which was taxed as a partnership.[1] Abingdon, in turn, held a partnership interest in Wacker-Madison Funds, LLC, another Illinois limited liability company that was also taxed as a partnership. For the 2002 tax year, the Petitioners claimed a $495,000 loss from Abingdon on their joint individual income tax return, which allegedly flowed through to them from Abingdon, as its share of a larger loss claimed by Wacker-Madison.

Wacker-Madison's 2002 tax returns were audited by the IRS, and the IRS adjusted its income pursuant to a settlement between the parties. There is no dispute that Abingdon was included in this settlement, and that on June 19, 2008, Rogers, who was Abingdon's tax managing partner, executed an IRS Form 870-LT on Abingdon's behalf, agreeing to the partnership adjustment of the Wacker-Madison settlement. As a result of the adjustment, certain losses were disallowed and income allocated to the Petitioners' joint federal return, resulting in additional adjusted gross income of $1,184,185, taxable income of $1,123,281, and a corrected federal income tax liability of $356,000. The final assessment was made as of May 25, 2011, as reflected on the IRS account transcript.

[1] The Petitioners are husband and wife, filing jointly. The transactions giving rise to the tax dispute in issue were conducted by the husband John E. Rogers.

The Petitioners did not file amended returns or provide any notice of the federal change to the Department. Nor did they pay their additional federal tax. On or about January 9, 2012, the IRS issued a notice of intent to levy, and on, or about, February 6, 2012, the Petitioners filed a federal Form 12153, Collection Due Process Hearing Request, seeking review of the levy notice. Further, on June 4, 2014, the Petitioners filed a complaint in the United States Tax Court in *John E. & Frances L. Rogers v. Commissioner of Internal Revenue*, No. 20882-14, purportedly challenging the IRS's actions in adjusting the Petitioners' 2002 income tax. In that action, the Petitioners claimed that the IRS had erred in allocating income to them that they had not in fact received and by not providing them a notice of deficiency from which to challenge the May 25, 2011 adjustment.

On June 9, 2014, the Department issued a notice of deficiency against the Petitioners for an additional $72,337 in Illinois income tax and interest based on the federal adjustment for the 2002 tax year. The notice of deficiency stated that the Department obtained the federal adjustment "from the Internal Revenue Service," and the Petitioners "did not timely notify" the Department "of the final federal change" under section 506(a) and 506(b) of the IITA, 735 ILCS 5/506(a), 5/506(b).

On August 6, 2014, the Petitioners timely filed their petition in the Tribunal challenging the Department's notice of deficiency. In the petition, the Petitioners alleged numerous errors by the IRS, particularly in allocating partnership income to them as individuals. But the basis for the claim against the Department was that the Petitioners had no obligation to give it notice of a federal change, because the federal change was not yet final, but still subject to a federal adjudication.

On January 6, 2015, the U.S. Tax Court dismissed the Petitioners' federal tax case for lack of jurisdiction. In its dismissal order, the U.S. Tax Court agreed with the IRS's position that the assessment against the petitioners arose from the Wacker-Madison adjustments, which flowed to Abingdon and which, in turn, flowed to petitioner husband, John E. Rogers. Rogers had waived "the restriction on assessment and collection" of the 2002 adjustments and also the right to a notice of deficiency by signing the Form 870-LT and agreeing to the Wacker-Madison settlement. Because Petitioners had waived the right to a notice of deficiency, they had no right to receive one, and the U.S. Tax Court had no jurisdiction over their claim.

The Tax Court, however, found that Petitioners were entitled to a collection due process hearing before the IRS. The Petitioners subsequently advised the Tribunal that a collection due process hearing has been scheduled by the IRS. The IRS settlement officer's letter scheduling the hearing noted that under section 6330(c)(2)(B) of the Internal Revenue Code, if the Petitioners "received a Statutory Notice of Deficiency or otherwise had an opportunity to dispute the liability," they "may not raise as an issue the amount or existence of the underlying assessment." Doc. 21, Status Report. The settlement officer further noted that Petitioners "signed a waiver or agreement consenting to the assessment." *Id.*

The Parties' Arguments

In its motion for summary judgment, the Department argues that, under section 506(b) of the IITA, the Petitioners were required to provide notice within 120 days of the date that their 2002 federal adjusted gross income was "'agreed to or finally determined.'" Doc. 10, Mot. for Summ. J. at 10. According to the Department, Rogers agreed to a federal adjustment when he executed the Form 870-LT entering into a settlement agreement on behalf of Abingdon on June 19, 2008, and, this adjustment was finalized when the IRS account transcript was adjusted on May 25, 2011. The Petitioners did not give the statutory notice to the Department within 120 days of the federal change, and the Department's notice of deficiency issued on June 9, 2014 was timely.

Petitioners contend that there has never been a final federal determination triggering the obligation to give the Department notice of the federal change. Rather, according to Petitioners, the 2008 settlement on behalf of Abingdon leaves their adjusted gross income "an open issue." Doc. 19, Pet. Obj. at 7. They characterize the May 25, 2011 assessment on the account transcript as "not sufficient evidence of the finality of the petitioner's 2002 gross income" because it is "mere hearsay," and the result of "the administrative calculations of mere clerks," *Id*. at 8.

Primarily, however, the Petitioners argue for a stay pending the disposition of their U.S. Tax Court or IRS proceeding. Initially, according to the Petitioners, the matter of the finality of the IRS's actions was before the U.S. Tax Court, and the Tribunal proceeding should be stayed pending the determination of what is essentially a matter of federal law. Now, given that the Tax Court dismissed their federal tax petition and the matter has been remanded for a collection due process hearing, the Petitioners contend that they may yet "contest the 2002 assessment on the merits" in that proceeding. Doc. 21, Pet. Status Report.

The dispute over the finality of the IRS's actions, likewise, provides the basis for the Department's motion for bond. The Department contends that the waiver and finality of the assessment is so obvious, that the Petitioners' argument otherwise is frivolous and is primarily for the purpose of "delaying the collection of tax." Doc. 13, Dep't Mot. For Bond at 3. Thus, if the case is stayed pending the determination of the federal tax proceedings, Petitioners should be required to post a bond under section 1-45(c) of the IITTA, 35 ILCS 1010/1-45(c). *See id.*

Analysis

The controlling issue here is whether the Department's notice of deficiency was timely filed or whether it is premature due to the ongoing federal proceedings. The issue of the timeliness of the Department's actions will resolve all of the pending motions before this Tribunal—whether the Department is entitled to summary judgment, the Petitioners are entitled to a stay, or, in the event that a stay is granted, the Petitioners are required to post a bond.

The Motion for Summary Judgment

"Summary judgment is proper when '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 a judgment as a matter of law." *Metro. Life Ins. Co. v. Hamer*, 2013 IL 114234, ¶17 (2013) (quoting 735 ILCS 5/2-1005(c) (2010)). The timeliness of the Department's notice of deficiency depends upon whether there was a federal change that the Petitioner was required to give the Department notice of under section 506(b) of the IITA. Section 506(b) requires that the notice of a federal change "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). Put another way, a taxpayer has 120 days to notify the Department of a federal change from the date that the change (1) has "been agreed to"; (2) has been "finally determined for federal income tax purposes"; (3) has been "assessed"; or (4) has been "paid." *Id.* Here, of course, the Petitioners have not paid the disputed taxes, and the parties focus on whether the federal adjustment has been agreed to or finally determined.

A. The Federal Change was "Agreed To" Within the Meaning of Section 506(b).

Whether the Petitioners "agreed to" the federal change and were required to provide notice of it to the Department under section 506(b) turns on the effect of the agreement Rogers entered into on behalf of Abingdon and the subsequent attribution of partnership income to the individual Petitioners. Abingdon was taxed as a partnership, and partnerships are pass-through entities for the income of the partners. *See United States v. Basye*, 410 U.S. 441, 448 (1973). Before the enactment of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), as part of the Internal Revenue Code ("IRC") (*see* Public Law No. 97–248, 96 Stat. 324), the federal income tax treatment of partnership pass-through items were ascertained at the taxpayer level. *See Huff v. Comm'r*, 138 T.C. 258, 263 (U.S. Tax Ct. 2012); IRS Pub. 541, at 13. This meant that, in a multi-tiered partnership, the IRS had to examine all entities with pass-through items at the same time. *See Parma v. United States*, 45 Fed. Cl. 124, 132 (1999); IRS Pub. 541, at 13.

Under TEFRA, pass-through items are considered at the partnership level rather than at the individual taxpayer level. *Parma*, 45 Fed. Cl. at 132; *see Hudspath v. Comm'r*, 2004 WL 532202, *2 (U.S. Tax Ct. 2004). And in cases where "1 or more partners in a partnership" settle a tax dispute with the IRS, "with respect to the determination of partnership items for any partnership," the settlement agreement is "binding on all parties to such agreement with respect to the determination of partnership items for such partnership taxable year." 26

U.S.C. § 6224(c)(1). With certain exceptions not relevant here, "[a]n indirect partner is bound by any such agreement entered into by the pass-thru partner." *Id.*

An "indirect partner" is a person holding an interest in a partnership through one or more pass-thru partners. *Id.*, § 6231(a)(10). A pass-through partner is "a partnership, estate, trust, S corporation, nominee, or other similar person through whom other persons hold an interest in the partnership with respect to which proceedings under this subchapter are conducted." *Id.*, § 6231(a)(9). An individual partner's federal tax return must treat the same partnership item consistent with its treatment on the partnership's return. *See id.*, § 6222.

There is no dispute here that Wacker-Madison was a qualifying TEFRA partnership, s*ee Wolf v. Comm'r*, T.C. Memo 1991-212, 1991 WL 77553, ("All partnerships required to file returns under section 6031(a) and whose tax years begin after September 3, 1982, are subject to the procedures set forth in . . . TEFRA"), *aff'd*, 4 F.3d 709 (9th Cir. 1993); IRS Pub. 541, *Partnerships*, at 13, or that it entered a settlement agreement with the IRS, s*ee* Doc. 11, Dep't Mot. for Summ J., Ex. 3; Doc. 20, Pet. Ex. 1, IRS Form 886-A. Regardless of whether Abingdon qualified as a TEFRA partnership, it was clearly a pass-through partner under TEFRA, and Rogers was thus an indirect partner of Wacker-Madison. *See* Doc. 20, Pet. Ex. 1, p.3, ¶ g.

Petitioners do not contest the fact of the Wacker-Madison settlement agreement or Abingdon's participation in that agreement. *See* Doc. 19, Pet. Obj. at

6 ("Abingdon agreed to the settlement agreement in Wacker Madison and nothing more."); Doc. 11, Mem. in Supp. of Sum. J. at Ex. 2 at 14. Nor do they offer any facts or law to dispute the pass-through effect of the settlement. Under TEFRA, petitioner Rogers qualified as an indirect partner of Wacker Madison, and the Wacker Madison adjustments flowed through to Abingdon to him and his wife, the individual Petitioners. 26 U.S.C. 6224(c)(1).

Instead, Petitioners object to the amount of the federal adjustment because they did not receive any cash and "enjoyed no accession to wealth." Doc. 19, Pet. Obj. at 8-9. But this argument ignores the longstanding principle that an individual partner is taxable on his distributive share of partnership income regardless of whether the income was actually distributed. *See Basye*, 410 U.S. at 447-48. Indeed, "[f]ew principles of partnership taxation are more firmly established than that no matter the reason for nondistribution each partner must pay taxes on his distributive share." *Id.* at 454; *see also Burke v. Comm'r*, 485 F.3d 171, 174-75 (1st Cir. 2007); *Brennan v. Comm'r*, T.C. Memo 2012-209 (July 23, 2012) (requiring taxpayers who were members of an LLC treated as a partnership to pay income tax on their distributive share of capital gain income from LLC's sale of assets even though no distribution was made).

More important, the federal adjustment's correctness is not relevant here. [2] The question before the Tribunal is whether Petitioners were required to provide

[2] And, likewise, Petitioners' brief reference to innocent spouse relief, Pet. Obj. at 4, is also irrelevant.

notice of the federal change to the Department. What matters here is that Wacker-Madison agreed to certain adjustments and that as part of the Wacker-Madison agreement, these adjustments flowed through to Abingdon and to the Petitioners individually. By agreeing to the Wacker-Madison adjustments, Petitioner Rogers waived his right to challenge the federal adjustments, and this waiver, in turn, triggered his obligation to notify of the Department of the federal change within 120 days, under section 506(b) of the IITA.

B. The IRS Made a Final Assessment of the Federal Change.

Moreover, the IRS's May 25, 2011 adjustment reflected on the IRS account transcript was a final assessment triggering Petitioners' obligation under section 506(b). Under section 506(b), either a "final determination" of the IRS or an "assessment" triggers the reporting obligation. Although these are arguably distinct events, it is unnecessary to determine the scope of that issue here, as the account transcript is sufficient evidence of the assessment's finality. *See Standifird v. Comm'r*, T.C. Memo 2002-245, 2002 WL 31151194 (2002) (holding that account transcript provided all the indicia necessary to verify IRS assessment); *see also Nestor v. Comm'r*, 118 T.C. 162, 169 (2002) (Marvel & Swift, JJ., concurring). (holding that hearing officer properly relied on account transcript to verify the fact of the assessment).

The Petitioners contend that the amount of the assessment is hearsay, characterizing it as arising from untested "administrative calculations by mere clerks" that is not evidence of the "proof of its contents" or its "correctness." Doc. 19, Pet. Obj. at 8. But in charging hearsay, Petitioners do not take issue with the account transcript's authenticity or the fact that the assessment was made. *See id.* (admitting that "the fact proven is that the number was entered on the transcript"). It is the fact of the assessment (which it is undisputed that Petitioners had notice of) that triggered Petitioners' obligation to report to the Department under section 506(b), not its correctness. Under section 506(b) of the IITA, the Petitioners had 120 days from the May 25, 2011 assessment to report the federal change. They did not do so, and the June 9, 2014 notice of deficiency is not premature.

C. The Department is Entitled to Summary Judgment.

In sum, whether through waiver or final assessment, section 506(b)'s notification requirements were triggered. Under section 506(b) the Petitioners had 120 days from either of these events to notify the Department of the federal adjustment. They did not do so and the Department's Notice of Deficiency was not premature. The Department is entitled to summary judgment in its favor.

The Petitioners' Stay Motion

The Petitioners also moved to stay this proceeding on the ground that the merits of their tax claim would be addressed in the Tax Court in *John E. Rogers & Frances L. Rodgers v. Commissioner*, No. 208820-14. Petitioners have the burden to clearly and convincingly demonstrate that a stay is necessary because the burden on them of going forward outweighs any harm to the opposing party or others. *See Kaden v. Pucinski*, 263 Ill. App. 3d 611, 615-16 (1st Dist. 1994). Further, the Tribunal's exercise of discretion to stay a proceeding in favor of a similar matter pending in another jurisdiction should be guided by considerations of "(1) comity; (2) the prevention of multiplicity, vexation and harassment; (3) the likelihood of obtaining complete relief in the foreign jurisdiction; and (4) the *res judicata* effect of a foreign judgment in the local forum." *Id.* at 616; *see also Hapag-Lloyd (Am.), Inc. v. Home Ins. Co.*, 312 Ill. App. 3d 1087, 1096 (1st Dist. 2000); *Van der Hooning v. Bd. of Trs. of the Univ. of Ill.*, 2012 IL App (1st) 111531, ¶ 25.

It is not necessary to delve into the discretionary stay factors in detail. It is sufficient to note that the Tax Court dismissed the action on the ground that it lacked jurisdiction to hear Petitioners' case because Petitioner Rogers "waived the restriction on collection and assessment," and the IRS assessed the federal deficiency on May 25, 2011. *See John E. Rogers & Frances L. Rodgers v. Comm'r*, No. 208820-14 (Jan 6, 2015). The Tax Court remanded the matter to the IRS for a collection due process hearing, and the IRS settlement officer assigned to the collection due process proceeding notified the Petitioners that she "may not be able" to consider the underlying assessment because the Petitioners "signed a waiver or agreement consenting to" it. *See* Doc. 19, Pet. Status Report. Thus, the limited right to challenge the "amount of the underlying tax liability" in a collection due process hearing proceeding, if "the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability," under 26 U.S.C. § 6330(c)(2)(B), is unavailable. It follows that the possibility of duplicative litigation in another forum, which might impact the decision in this case is, at best, too remote.

In any case, according to the Department, in the event that the IRS further adjusts the Petitioners' 2002 federal income tax adjustment and that such adjustment reduces the Petitioners' 2002 Illinois income tax, Petitioners will have the opportunity to file an amended Illinois income tax return and seek an income tax refund. *See* Doc. 23, Dep't Reply at 5 (citing 35 ILCS 5/506(b), 5/911(b)). The Petitioners have not provided a clear and convincing justification to stay the current proceeding.

The Department's Motion for a Bond

The Department also filed a motion for bond, seeking an order directing Petitioners to post a bond pursuant to section 1-45(c) of the IITA, 35 ILCS 1010, 1-45(c), in the event that a stay is granted. Section 1-45(c) authorizes the Tribunal to impose "a bond equal to 25% of the liability at issue" if the Department shows that a taxpayer's arguments "are frivolous or legally insufficient" or that "the taxpayer is acting primarily for the purpose of delaying the collection of the tax or prejudicing the ability ultimately to collect the tax." 35 ILCS 1010/1-45(c) (2012).

The Tribunal need not reach the issue of whether a bond is appropriate here, as it has denied the Petitioners' motion for stay and granted summary judgment in the Department's favor. Given that the Department has its full relief, the motion for bond is denied as moot. *See Leatherman v. Comm'r*, T.C. Memo 1989-650, 1989 WL 148341, *3 (T.C. 1989); *Kaden*, 263 Ill. App. 3d at 613.

CONCLUSION

The Department's motion for summary judgment is granted and summary judgment is granted in favor of the Department and against the Petitioner. The Petitioners motion to stay is denied. The Department's motion for bond is, accordingly, denied. As the sole basis, for the Petitioners' objection to the Departments notice of deficiency was that it was premature, the entry of summary judgment effectively disposes of this case and this decision is final.

s/ *Brian Barov*
BRIAN F. BAROV
Administrative Law Judge

Date: April 27, 2015