IT 97-9
Tax Type: INCOME TAX
Issue: Net Operating Loss (General)

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

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS,	)	
v.	)	**No.**
	)	**FEIN:**
TAXPAYER,	)	
	)	**C. O'Donoghue**
	)	**Admin. Law Judge**
Taxpayer	)	

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Joseph D. Ament, of Much, Shelist, Freed, Denenberg, Ament, Bell & Rubenstein, P.C. for TAXPAYER; Ms. Lois Solomon, Special Assistant Attorney General, for the Illinois Department of Revenue.

Synopsis:

This matter comes on for hearing pursuant to the taxpayer's timely protest of the Notice of Deficiency issued by the Department on October 4, 1996. At issue is whether the penalties proposed under Section 1005 of the Illinois Income Tax Act ("IITA") should be abated due to reasonable cause. Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the taxpayer.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence of the Notice of Deficiency, showing a total liability due and owing in the amount of $150,452.00. Dept. Ex. No. 1.

2. The taxpayer took a subtraction modification for the gross amount of income earned on U.S. obligations when filing its original 1991 and 1992 IL-1120 tax returns. Tr. pp. 7, 8. The returns were filed in reliance on the policy stated in private letter ruling ("PLR") IT-91-53. Taxpayer Ex. No. 1.

3. During audit, the Department adjusted the subtraction modification for interest income from U.S. government obligations to show net interest pursuant to Section 203(b)(2)(J). Dept. Ex. No. 1.

4. The taxpayer has filed Forms IL-1120X for taxable years 1991 and 1992 electing to carry Illinois net operating loss amounts in such a manner so that they are applied to reduce the tax deficiencies being proposed in the Notice of Deficiency to zero. Taxpayer seeks abatement of the Section 1005 penalties due to reasonable cause. Taxpayer Ex. No. 1; Dept. Ex. No. 2.

5. Taxpayer had been given PLR IT-91-53 issued March 5, 1991, by a large CPA firm. Tr. pp. 8, 11; Taxpayer Ex. No. 2. The taxpayer was not the subject of the private letter ruling request. Taxpayer Ex. No. 2.

6. PLR IT-91-53 indicated that a taxpayer may determine the subtraction modification for income earned on U.S. Treasury obligations according to the gross coupon rate rather than an amount net of related bond premium amortization expense under IRC §171. Taxpayer Ex. No. 2.

7. Taxpayer gave PLR IT-91-53 to its CPA firm, Hutton, Nelson & McDonald, LLP, who normally prepared its' tax returns. The firm relied on PLR IT-91-53 in preparing taxpayer's 1991 and 1992 IL-1120 returns. Tr. pp. 10, 11.

8. On March 7, 1994, the Department issued PLR IT-94-0009 thereby revoking IT-91-53. On February 10, 1995, the Department issued a corrected PLR IT-94-0009. PLR IT-94-0009 indicated that taxpayers must report the income earned on U.S. Treasury obligations net of related bond premium amortization expense. It further stated that IT-91-53 had not been a valid expression of Department policy since the amendment of the tax form instructions in 1991. Taxpayer Ex. No. 3.

Conclusions of Law:

At issue is whether the Department's proposed assessment of penalties under § 1005 of the IITA should stand. For periods prior to January 1, 1994[1], Section 1005 provides in part:

> If any amount of tax required to be shown on a return prescribed by this Act is not paid on or before the date required for filing such return (determined without regard to any extension of time to file), a penalty shall be imposed at the rate of 6% per annum upon the tax underpayment unless it is shown that such failure is due to reasonable cause... .

35 **ILCS** 5/1005.

[1]. As of January 1, 1994, Section 1005 penalties are provided for under the Uniform Penalty and Interest Act. *See*, 35 **ILCS** 735/3-1 *et seq*.

To avoid the imposition of the Section 1005 penalty under the IITA, a taxpayer must affirmatively put forth evidence which establishes that the taxpayer made a good faith effort to determine his liability and exercised ordinary business care and prudence. *See*, IRC Sec. 6664(c); 86 Admin. Code ch. I, § 700.400.[2] Ordinary business care and prudence is determined by examining all of the facts and circumstances in a particular case.

It has invariably been the policy of the Department that private letter rulings are only binding as to the taxpayer which is the subject of the letter ruling. *See*, 2 Admin. Code ch., I, § 1200.110(a). The issue remains whether given the circumstances presented, the taxpayer exercised ordinary business care and prudence in ultimately determining its tax liability according to the policy outlined in PLR 91-IT-53.

In the case at hand, the taxpayer received PLR 91-IT-53 from a respected CPA firm. Thereafter, they consulted their own CPA firm, Hutton, Nelson & McDonald, LLP, who they had trusted to file their returns in the past. This CPA firm with all its training and tax expertise filed the taxpayer's returns relying on IT-91-53. It is this important fact, I believe, which most strongly reflects the taxpayer's good faith effort to comply with the law. A taxpayer's reliance on an outside tax professional does constitute reasonable cause under federal law. *See e.g.*, Haywood Lumber & Mining Co. v. Commissioner, 178 F.2d 769 (2nd Cir. 1950).

Reliance on the advice of a professional does not always establish that a taxpayer exercised ordinary business care and

[2]. Adopted at 18 Ill. Reg. 1561, effective January 13, 1994.

prudence. However, the record reflects that similar facts existed as those presented in the letter ruling. Furthermore, given the contradictory information issued by the Department at the time, and that the Department's modification of its tax forms only just began the same year as one of the tax years in question, it appears that reliance on its CPA firm was reasonably prudent. Taxpayer believed the PLR was an accurate reflection of Department policy at the time it filed its return. Taxpayer Ex. No. 1; Tr. p. 13. It exercised caution and showed a good faith effort to comply with the law by consulting respected outside tax professionals. The fact that taxpayer's CPAs did not correctly interpret Department policy and file the return accordingly does not demonstrate that the taxpayer failed to exercise ordinary business care and prudence.

Wherefore, for the reasons stated herein, the Section 1005 penalties should be abated.

Christine O'Donoghue
Administrative Law Judge