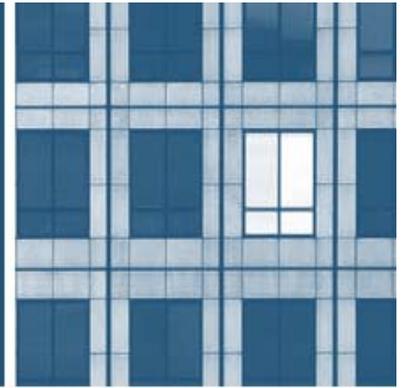


# On the Subject



## State & Local Tax

October 20, 2010

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Under the recently enacted Illinois Tax Amnesty Program, taxpayers can avoid penalties and interest for eligible prior year tax periods, but they risk 200 percent penalties and interests for liabilities not paid during the amnesty program, which ends November 8, 2010.

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Illinois taxpayers have a window of opportunity to avoid penalties and interest on prior year tax liabilities under the Illinois Tax Amnesty Program that expires November 8, 2010. The Tax Amnesty Program contains pitfalls as well as opportunities for avoiding penalties and interest for prior periods. Payment of eligible tax liabilities during the amnesty period will result in abatement of all penalties and interest for the relevant tax period, but failure to pay most eligible liabilities will expose the taxpayer to double penalties and interest.

Among the important planning opportunities under the Tax Amnesty Program are the following.

### **Federal Changes**

Double interest and penalties will not be assessed against income tax liabilities arising from federal changes that are not final by November 8. In addition, taxpayers can avoid interest entirely by paying estimated amounts of anticipated federal change liabilities during the amnesty period (with a true-up when the federal changes are final, with interest at the regular rates rather than 200 percent interest on the true-up payment). Accordingly, taxpayers that can estimate the amount of forthcoming federal tax changes can avoid interest charges on the corresponding Illinois income tax liability by paying an estimate under the amnesty program by November 8.

### **Taxpayers Under Audit**

Taxpayers subject to an audit that cannot be completed by November 8 can pay an estimated amount of tax expected to be assessed at the close of the audit with no penalties or interest, with a true-up payment at the close of the audit (and double

penalties and interest only on the true-up payment). However, once the audit is completed, the taxpayer's right to contest unagreed on issues is limited. If the taxpayer disagrees with any part of the audit results and challenges those results by a protest or refund claim, the taxpayer must prevail in that challenge in order to preserve the abatement of penalties and interest for the entire period involved in the dispute. If the taxpayer loses its challenge, double penalties and interest will apply to the entire amount, including the estimated amount paid during the amnesty period. In general, the taxpayer will not be permitted to file a refund claim for overpayment of its estimated tax liability.

### **Taxpayers not Under Audit**

Taxpayers that are not subject to an audit for a particular tax period also can file an amended return and pay an estimated amount of tax with respect to that period, with no penalties or interest due to the amnesty program. If the tax period subsequently is audited and the Illinois Department of Revenue asserts additional tax is due, the department will demand a true-up payment at the close of the audit (and double penalties and interest only on the true-up payment). Although the Illinois Department of Revenue's emergency regulations are not entirely clear on this point, it is possible that a taxpayer that is not subject to an audit may be permitted to file a refund claim for overpayment of its estimated tax liability.

### **Use of Protest Monies Act**

Taxpayers under audit with matters that are eligible for the Protest Monies Act litigation procedure may litigate their tax disputes by paying the tax under protest and filing a case in circuit court. If the case is filed prior to the end of amnesty period on November 8, the relevant tax period will not be eligible for the amnesty program, and double penalties and interest cannot apply to that tax period. Protest Monies Act cases generally are filed after a taxpayer receives a notice of deficiency or a notice of tax liability, but courts have sustained the filing of the Protest Monies Act procedure after a taxpayer receives a proposed notice and also for cases in the administrative hearings division if substantial progress toward a hearing has not occurred. Taxpayers that are

eligible for the Protest Monies Act procedure can contest their tax liability in court without exposure to 200 percent penalties and interest. The normal interest and penalties will apply.

**Caution!**

Taxpayer rights to receive refunds of tax liabilities for overpayments made on an estimated basis during the amnesty periods may be limited. The Illinois Department of Revenue's emergency amnesty regulations do not clearly delineate the situations in which refunds may be allowed, particularly when a taxpayer files an amended return and pays an estimated liability, and different rules may be applied depending on whether the taxpayer is under audit or not under audit for the tax period. Practitioners are discussing these procedural issues with the Illinois Department of Revenue, and taxpayers that intend to pay estimated tax liabilities during the amnesty program to avoid double penalties and interests are cautioned to consider their refund rights carefully and to review the situation with tax counsel.

**Amnesty Program Details**

On August 16, 2010, Governor Quinn signed the latest Illinois Tax Amnesty Program bill into law as Public Act 96-1435. The new Tax Amnesty Program adopts many features of the 2003 amnesty program, including the carrot of a full abatement of all interest and penalties applicable to taxes paid under amnesty, and the stick of doubling penalties and interest for eligible tax liabilities that are not paid during the amnesty period. However, the new Tax Amnesty Program also makes several important changes, including relief from double interest for payments made as the result of federal changes that are not final before the close of the amnesty period. The Illinois Department of Revenue has issued detailed emergency regulations that interpret the new tax amnesty statute and clarify many issues that arose from the 2003 amnesty program. 86 Ill. Admin. Code sec. 520.101 and 520.105 (Emergency), 34 Ill. Reg. 15515 (October 8, 2010). Available on the Illinois Department of Revenue website.

The major features of the Tax Amnesty Program are as follows:

- Amnesty payments must be made during the period beginning October 1 and ending November 8, 2010. This amnesty period straddles election day, November 2, which may affect the state's ability to entertain and act on settlement offers late in the amnesty period.

- The Tax Amnesty Program applies to tax periods ending after June 30, 2002, and prior to July 1, 2009. Taxes attributable to periods ending on or before June 30, 2002, are not eligible for amnesty.
- The Tax Amnesty Program applies to all taxes administered by the Illinois Department of Revenue, except the motor fuel tax (and not taxes that are not administered by the department, including the corporate franchise tax, unemployment tax or unclaimed property obligations).
- Taxpayers party to civil or criminal litigation in court are not eligible to participate in the amnesty program. However, taxpayers may dismiss civil litigation in order to participate in the amnesty program.
- Taxpayers with cases in administrative hearings may participate in the amnesty program by paying the full amount of tax in dispute or by agreeing to a settlement with the Illinois Department of Revenue, and failure to do so will result in imposition of doubled penalties and interest.

As summarized above, and unlike the prior amnesty program, double interest and penalties will not apply to income tax liabilities that arise from federal audit changes that become final after the close of the amnesty period on November 8. In addition, taxpayers may pay estimated amounts of income tax attributable to federal changes that have not become final. If paid during the amnesty period, no interest will be due on those estimated federal change payments, and regular single interest will be due upon final payments after the federal audit is complete.

Taxpayers under audit may participate in the amnesty program by reporting and paying the amount of an eligible liability that the taxpayer estimates will result from the audit, with no penalties or interest, and pay any remaining amount due on the conclusion of the audit with double penalties and interest. However, as stated above, the taxpayer will be required to pay the final amount asserted by the auditor at the close of the audit, with double penalties and interest, or choose to contest the auditor's final assessment and risk double penalties and interest for the entire amount paid for the tax period if the contest is unsuccessful.

## Taxpayers Should Consider Amnesty Now

Taxpayers with complicated situations should consult with their tax advisors to decide on a course of action under the Illinois Tax Amnesty Act. There are numerous procedural pitfalls that may surprise taxpayers that pay taxes during the amnesty program, particularly with regard to rights to receive refunds of overpaid taxes. Nevertheless, the carrot of complete forgiveness of penalties and interest for eligible tax periods, combined with the 200 percent penalties and interest for tax liabilities not paid during the amnesty program, presents a powerful incentive to pay under amnesty.

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