

Alert 10-196



## Illinois Tax Amnesty Signed Into Law . . . Again

Despite his previously stated misgivings about frequent amnesty programs, Illinois Gov. Patrick Quinn (D) signed Senate Bill (SB) 377, Public Act (P.A.) 96-1435, into law August 16, 2010, and so Illinois will conduct its second general tax amnesty in seven years.

SB 377 amends the Tax Amnesty Delinquency Act (the "TDAA" or the "New Amnesty Law"), which was first enacted for the amnesty Illinois conducted in 2003. Under the New Amnesty Law, the Illinois Department of Revenue (the "Department") will administer an amnesty program from October 1, 2010 through November 8, 2010 (a period a week shorter than the last Illinois amnesty program in 2003) for any taxable period ending after June 30, 2002 but prior to July 1, 2009. As was the case under the 2003 amnesty program, a payment of tax during the amnesty period is rewarded with a full abatement of penalties and interest, but failure to pay the tax amounts owed to the Department during the amnesty program will result in imposition of penalties and interest at 200 percent of the otherwise applicable rates.

The New Amnesty Law holds perils as well as opportunities, depending on what stage of the tax lifecycle a taxpayer is dealing with, and the distinctions under the law for who may benefit or be imperiled do not all make sense. The following questions and answers describe how the New Amnesty Law applies to different stages of the tax lifecycle:

Is amnesty available for a final assessed liability (i.e., a liability that was not protested within the time allowed, or for which all avenues of protest were exhausted, unsuccessfully)?

Yes, quite surprisingly. Amnesty is available for a taxpayer owing "any tax imposed by" Illinois law and "collected by the Department," and the TDAA does not distinguish between tax debt unknown to the Department and a tax debt the Department assessed and finalized but that remains unpaid. Pay the tax amount during the October 1 through November 8 amnesty period, and you may forget the penalties and interest. The Department's 2003 Emergency Regulations for the TDAA did not foreclose this reading of the TDAA for the 2003 amnesty program, but had they done so, it appears that position is directly contrary to the broad language of the TDAA that remained unchanged in SB 377.

Is amnesty available for a tax liability that has been assessed, but is being protested and is pending on October 1, 2010?

It depends.

No, if the liability is being contested through criminal or civil litigation in the court system.

Yes, if the liability is being contested through an administrative protest or hearing before the Department.

The New Amnesty Law renders ineligible for amnesty any taxpayer who is a party to criminal or civil litigation involving a tax year otherwise eligible for amnesty. Fortunately, because such taxpayers are not eligible for amnesty, they also will not be exposed to any doubling of interest and penalties for not taking advantage of amnesty if the litigation concludes unsuccessfully for them.

However, "civil litigation" does not encompass taxpayers who have an administrative protest and hearing request pending before the Department on a Notice of Tax Liability (sales/use and excise taxes) or a Notice of Deficiency (income taxes). Such taxpayers are eligible for amnesty and so they will see their penalties and interest doubled

by operation of law if they don't participate in the amnesty program before it ends November 8.

Is amnesty available for a tax liability that is not yet assessed, but that may result from a Department audit that is pending on October 1, 2010?

Yes. From October 1, 2010 through November 8, 2010, a taxpayer may file amended returns reporting additional liability for any open period, even if the period is under audit, and pay only the tax estimated to be due, and avoid paying penalties or interest on that amount.

If the estimate is higher than the eventual audit determination, a taxpayer forfeits the overpayment, but a taxpayer may still seek a refund of overpayments related to issues other than those that generated the liability paid under amnesty.

If the estimate is lower than the eventual audit determination, a taxpayer will be subject to interest and penalties on that deficiency at 200 percent of the otherwise applicable rates.

Is amnesty available for liability that may result from an adjustment by the Internal Revenue Service to a tax year that is eligible for amnesty, but as to which the adjustment is not final or for which an audit by the IRS has not yet commenced?

Yes. As was the case with the TDAA amnesty program last administered in October and November 2003, the Department will accept anticipatory reports of a "federal change" (an increase in Illinois liability resulting from a final adjustment of federal tax liability). However, unlike the case with the 2003 TDAA amnesty program, taxpayers who would rather not participate in the amnesty program and who will follow the usual reporting and payment deadlines of the Illinois Income Tax Act (the "IITA")—even though these may fall after the 2010 amnesty period—will not be subjected to penalties and interest at 200 percent of the otherwise applicable rate (versions of the bill before it was sent to the governor did not offer this protection). A taxpayer choosing to make an anticipatory payment during amnesty will avoid interest on that amount. If the taxpayer later reports the federal change, any additional amount it may owe at the time the change is reported will bear interest and applicable penalties at the standard statutory rates. If such a taxpayer overpays tax relating to a federal change during the 2010 amnesty program, it may seek a refund of the amount overpaid during the amnesty period.

Is amnesty available for unfiled tax returns?

Yes.

However, there is an interesting twist for remote vendors who have not filed returns and remitted use taxes for purchases made by Illinois customers.

Gov. Quinn also signed SB 459, a separate amnesty for individuals who owe use taxes on purchases from unregistered remote vendors that will run from January 1, 2011 through October 15, 2011. For tax periods starting after June 30, 2004 through December 31, 2010, such taxpayers may report use tax liability on such purchases from unregistered remote vendors on their Illinois personal income tax returns, so long as the liability does not exceed \$600. Query whether such remote vendors have an incentive to participate when they may be unjustly enriching the state if their Illinois customers also participate in the special amnesty under SB 459.

Are there taxpayers caught between amnesty and a hard place?

Yes. Taxpayers who have a protest to an assessment pending in administrative hearings can participate in the amnesty program if they surrender their due process right to contest the assessed liability and instead pay the assessed tax and interest during the October 1 through November 8 amnesty program. However, taxpayers with cases in the administrative hearings process that are not prepared to surrender their due process rights will increase their exposure for penalties and interest, as these will be imposed at 200 percent the otherwise applicable rate if the tax liability remains unpaid after November 8, 2010, and they are unsuccessful in their protest. Some of these taxpayers may seek to fall within the exclusion by attempting to have those cases removed to Circuit Court (by paying the amounts under protest using the State Officers and Employees Money Disposition Act) and, thus, avoid doubling of penalties and interest. We expect the Department to vigorously oppose such attempts, as the Department views the administrative protest and protest payment suits as an election of remedies question, such that the initial choice of one remedy renders the other unavailable.

We also expect the Department to oppose efforts by taxpayers under audit, who have not yet received a notice of deficiency or notice of tax liability, to short-circuit the audit process by paying the estimated liability for their audit under protest and starting a civil action seeking a refund of the protested payment. One appellate decision involving the 2003 amnesty program allowed a taxpayer, who had received an audit report but who had not been issued a notice of tax liability, to pay the anticipated assessment under protest and file an action in circuit court before the Department issued a notice of tax liability, thus avoiding the administrative hearings process. However, the decision is very narrowly tailored to the facts of that case and may not offer support for similar efforts by differently situated taxpayers.

Some taxpayers who are not eligible for amnesty because the amnesty-eligible tax year is pending in civil litigation may be able to make themselves eligible. Taxpayers that paid disputed assessments under protest pursuant to the State Officers and Employees Money Disposition Act have nothing to pay under amnesty, but they also do not face exposure to doubling of penalties and interest. However, taxpayers who are appealing an unfavorable administrative hearing decision by the Department (such appeals are made to the first judicial level, the circuit court), and for whom abatement of penalties and interest is an acceptable resolution of their case, may be able to voluntarily dismiss their actions and pay the tax amounts under amnesty from October 1 through November 8. Discussions with the attorney general's office and the Department may be necessary to obtain the necessary comfort level before dismissal of the action, since administrative review cases involving taxes cannot be reinstated after dismissal, as is allowed for a limited time for other cases.

Taxpayers under audit (including in Informal Conference) or in the administrative hearings process need to promptly consult with knowledgeable Illinois tax counsel and take steps to avoid doubling of penalties and interest by operation of law when the amnesty period closes November 8, 2010. Reed Smith is advising clients with procedural options specific to their situation.

## Emergency Regulations

It is anticipated that the Department will issue emergency regulations to administer the New Amnesty Law as it did for the 2003 amnesty. By issuing emergency regulations, the Department is able to avoid the notice and comment period required for non-emergency regulations. However, this means that there will be little direct taxpayer input into the emergency regulations as they are drafted by the Department. However, internal drafts of the emergency regulations suggest the final position on certain issues may be as follows:

- Unlike the 2003 amnesty program, the Department will not accept credit carryovers or other credit applications as a payment under amnesty, so cash, checks, guaranteed remittances or ACH debit payments only are expected to be accepted. However, at this time, the Department is considering whether to allow off-setting of overpayments as a payment for amnesty purposes. This also means that outstanding amounts of penalty and interest will not be abated if the underlying tax has already been paid prior to the start of the amnesty period.
- While taxpayers with pending civil litigation may become eligible to participate in amnesty by dismissing the action prior to the end of the amnesty period (in administrative review cases), or if judgment is entered dissolving any injunction protecting a protest payment made to initiate the action (in State Officers and Employees Money Disposition Act cases), it appears that the Department will insist on dismissal of the entire action, precluding a cherry-picking of issues for amnesty and issues for litigation. In that instance, taxpayers may be better off remaining in litigation to avoid doubling of penalties in the event their challenge is unsuccessful.
- While the Department will allow refunds of overpayments made in amnesty of estimated Illinois income tax liability that will result from a federal change that becomes final after the expiration of the amnesty period, it will not pay interest on that overpayment.
- For taxpayers that do not participate in the amnesty program and that are later subjected to double penalties, abatement of penalties for "reasonable cause" will continue unaffected by the amnesty program. Thus, if reasonable cause supports abatement of the underlying penalty, the abatement will extend as well to the doubled penalty amount.

The internal draft of the emergency regulation may change before it is promulgated. Reed Smith will continue to monitor and report on material amnesty program developments.

For more information on the New Amnesty Law, and how it applies to your specific situation, please contact the author of this Alert, or the Reed Smith attorney with whom you regularly work. For more information on Reed Smith's Illinois State Tax Practice, visit [www.reedsmith.com/iltax](http://www.reedsmith.com/iltax).

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