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Tax Trends 2004 Illinois Tax Update

BREAKING NEWS!

Circuit Court Holds Fund Surcharge in Budget Implementation Act Unconstitutional

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The Horwood Marcus & Berk State and Local Tax Group practices nationally in all areas of state and local taxation. The firm's state and local tax practitioners have extensive experience with income tax, gross receipts tax, franchise and capital stock tax, sales and use tax, utility and energy tax, unclaimed property, planning, and litigation issues. Clients of the State and Local Tax Group include Fortune 500 companies as well as mid-size and closely-held businesses.

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INCOME AND REPLACEMENT TAXES

Court Cases

Gain from Section 338(h)(10) Election Constitutes Non-Business Income

American States Insurance Company v. Hamer, 816 N.E.2d 659 (1st Dist. Ill. App. Ct., Aug. 27, 2004), reh'g denied (Oct. 19, 2004), petition for leave to appeal pending

The Appellate Court ruled that American States Insurance Company's ("American States") deemed sale of its assets pursuant to Section 338(h)(10) of the Internal Revenue Code constituted non-business income for Illinois income tax purposes.

American States, an Illinois taxpayer, is the designated agent of a group of combined insurance companies and their subsidiaries. In 1997, American States was a wholly-owned subsidiary of American States Financial Corp. ("ASFC"). Lincoln National Corporation ("Lincoln"), an Indiana corporation, owned more than 80% of ASFC's stock.

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American States Insurance Company v. Hamer continued

In October 1997, SAFECO Corporation purchased 100% of ASFC's stock from Lincoln and the minority shareholders, which resulted in a cash distribution to all shareholders. SAFECO then formed ASFC Acquisition Corporation, which merged with ASFC. American States continued doing business in Illinois after the sale.

For federal income tax purposes, both Lincoln (seller) and SAFECO (buyer) made a Section 338(h)(10) election to treat the stock purchase as an asset acquisition. Pursuant to a Section 338(h)(10) election, two separate corporations, Old Target and New Target, are considered to exist. Old Target is deemed to sell all of its assets to New Target, which is a new corporation that is unrelated to Old Target. New Target is deemed to pay the purchase price for Old Target's assets with cash and the assumption of Old Target's liabilities. Then, Old Target is deemed to distribute the cash proceeds received from New Target to its shareholders in complete liquidation.

As a result of the election, the acquired assets received a stepped-up basis, allowing for greater depreciation deductions. In addition, the target recognized the gain or loss on the deemed transfer of its assets. Lincoln avoided recognition of any gain or loss on the actual stock sale.

American States filed an Illinois tax return for 1997 and reported the $1.27 billion gain from its deemed asset sale as non-business income. The Department reclassified the gain as business income, resulting in a deficiency.

Under Illinois law in effect during the year at issue, income is business income if either the so-called "transactional test" or "functional test" is satisfied. These tests arose out of Illinois' definition of "business income." During the year at issue, Section 1501 of the Income Tax Act defined "business income" as: "income arising from transactions and activity in the regular course of the taxpayer's trade or business ***, and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." 35 ILCS 5/1501(a)(1)

The Department conceded that the gain was not business income under the transactional test. Rather, the Department based its claim on the "functional test," which is taken from the second clause of the "business income" definition. Quoting from *Texaco-Cities Service Pipeline Co. v. McGaw*, 182 Ill. 262, 272 (1998), the Appellate Court in American States explained that under the functional test the relevant focus is "the role or function of the property being [disposed of] as being integral to regular business operations." The nature or infrequency of the sale is irrelevant.

American States argued that its gain was non-business income based on the Appellate Court's decision in *Blessing/White, Inc. v. Zehnder*, 329 Ill. App. 3d 714 (2002), where that Court held that the taxpayer's liquidation gain was not business income under the functional test because the liquidation represented a cessation of its business operations and was not integral to the company's regular business operations. The Department argued that *Blessing/White* was wrongly decided and should not be followed. The Appellate Court in American States disagreed, noting "a reading of the plain language of *Texaco-Cities* shows that it concluded the gain was properly classified as business income because of a lack of evidence that the sale was a cessation of a separate and distinct portion of Texaco-Cities' business." Therefore, the *Blessing/White* Court correctly concluded that gain from a complete liquidation is non-business income.

The Appellate Court also rejected the Department's argument that American States' liquidation did not result in the discontinuation of its business activity. In its reply brief, the Department acknowledged that it recognized the fiction created by the Section 338(h)(10) election. The Appellate Court found that if the Department acknowledged Section 338(h)(10), it could not also argue that American States had continued its business operations. Based on these findings, the Appellate Court concluded that under the rule in *Blessing/White*, the gain was not business income.

HMB Comment:
The Appellate Court's decision is based on the "liquidation" exception to the functional test that was originally recognized by the Illinois Supreme Court in Texaco-Cities and later applied by the Appellate Court in Blessing/White. Effective July 30, 2004, the statutory definition of the term "business income" was amended to eliminate the functional test (see discussion pg. 9).

Appellate Court holds that Business Income of a Partnership is Apportioned at the Partner Level

Exxon Corporation v. Bower, No. 1-01-3302 (1st Dist. Ill. App. Ct., May 21, 2004) (unpublished), petition for leave to appeal denied (Ill. S., Ct., Oct. 6, 2004); and *BP Oil Pipeline Company v. Bower; Unocal Pipeline Company v. Bower*, Nos. 1-01-2364 and 1-01-2365 (1st Dist. Ill. App. Ct., May 21, 2004)(unpublished), petition for leave to appeal denied (Ill. S. Ct., Nov. 24, 2004)

In separate unpublished decisions involving the same legal issue, the Appellate Court determined that the business income of a partnership must be included in the apportionable tax base of its unitary corporate partners even though the partnership does not operate in Illinois. In Exxon, the Appellate Court also determined that penalties imposed by the Department of Revenue should be waived for reasonable cause.

Both cases concerned corporations that were non-controlling partners in partnerships that operated exclusively outside Illinois. For the relevant years, the corporate partners, relying on Section 305(a) of the Income Tax Act, did not include any of the partnerships' business income in their combined apportionable tax base. Section 305(a) provides that the business income of a partnership is apportioned at the partnership level, that is, by use of the partnership's apportionment factors and, to the extent apportioned to Illinois, is then picked up by each of the partners based on their respective distributive share and reported to Illinois as allocable income. Here, the partnerships did not operate in Illinois, so none of the partnership income was apportioned to Illinois and the partners reported none of their distributive shares of income to Illinois.

The Department disputed the partners' method for determining their net income. According to the Department, the relevant Act Section is 304(e), which provides for combined apportionment, and not 305(a) as relied on by the corporate partners. Under the Department's approach, if a partnership and its corporate partners are unitary (disregarding ownership percentages), then the business income and apportionment factors of the partnership are combined with the business income and apportionment factors of the corporate partner. Thus, a partnership's business income is apportioned by use of the entire group's apportionment factors.

In the Exxon and BP/Unocal cases, the result of the Department's determination was that some of the partnerships' business income would be apportioned to Illinois despite the fact that the partnerships did not operate in Illinois and despite the language of Section 305(a), which requires apportionment at the partnership level. The Department relied on its regulation, 86 Ill. Adm. Code Sec. 100.3380(d), in support of its position.

The Appellate Court agreed with the Department. According to the Appellate Court, the fact that Section 305(a) does not reference combined apportionment or unitary business groups does not mean that the combined apportionment method of determining taxable income could not be applied to a partnership and its unitary corporate partners. The Appellate Court also rejected the partners' arguments that Section 305(a) was the more specific statutory provision and, therefore, controlled over the general combined apportionment provision of Section 304(e). The Appellate Court concluded that there was no conflict between Sections 305(a) and 304(e) and that Section 304(e) addressed the specific question of apportioning business income for a unitary business.

In both cases, the Appellate Court rejected the partners' arguments that Regulation Section 100.3380(d) violated the Income Tax Act's definition of a unitary business group because the regulation explicitly provided that ownership requirements are disregarded in making a unitary determination. The Appellate Court rejected this claim, concluding that Section 304(e) conditions the application of combined apportionment upon the existence of a unitary business "as described" in Section 1501(a)(27) and that "ownership" is not part of the description in that statute. According to the Appellate Court, Section 1501(a)(27) describes a unitary business "not as common ownership but as activities [that] are integrated with, dependent upon and contribute to each other."

Finally, in the Exxon case, the Appellate Court determined that Exxon had reasonable cause for taking its position and found that the Department's proposed penalty assessment was unsupportable. Exxon argued that it relied on the advice of an experienced tax attorney in determining its reporting position. The administrative law judge upheld the imposition of penalties on the grounds that Exxon did not establish that it actually relied on the attorney's advice, as opposed to merely seeking a "second opinion" to support the position Exxon itself had already decided to take. The Appellate Court disagreed and concluded not only that reliance on the advice of a competent tax advisor constituted reasonable cause justifying full abatement of penalties, but also that Exxon sufficiently established that it sought and relied upon the advice of its tax attorney in determining its tax reporting position.

HMB Comment:
The Court's orders in these cases are unpublished. While publicly available on certain electronic subscription databases, except under certain limited circumstances, they may not be cited as authority in other cases.

Appellate Court Upholds Denial of Taxpayer's Claim for Attorneys' Fees because the Department's Assessment was based on "Reasonable Cause"

Hercules, Inc. v. Department of Revenue, 347 Ill. App. 3d 657, 807 N.E.2d 993 (1st Dist., March 26, 2004)

In what appears to be the final chapter in the controversy over Hercules' $1.3 billion capital gain, the Appellate Court denied the taxpayer's claim for attorneys' fees arising out of an earlier dispute with the Department of Revenue. The dispute arose when the Department claimed that Hercules owed taxes on a $1.3 billion capital gain from its sale of stock in its Himont joint venture, arguing that the gain constituted apportionable business income. Hercules contended that its joint venture holding had no connection to its sales activities in Illinois and that taxation of income from the sale of its minority holding was non-apportionable.

An administrative law judge (ALJ) agreed with the Department, holding that the gain qualified as business income under Section 1501(a)(1). The Circuit Court upheld the ALJ's determination and Hercules appealed.

On appeal, the Appellate Court reversed and found that Hercules' investment in Himont was unrelated to its activities in Illinois and that the capital gain recognized from that transaction was non-apportionable. The case was then remanded to the Circuit Court where Hercules requested that its count for attorneys' fees be reinstated. The Circuit Court reinstated the claim for fees, but then denied Hercules' motion for summary judgment on the issue and dismissed the case.

The question for the Appellate Court on this second appeal was whether the Department had "reasonable cause" for its determination that Hercules owed Illinois income tax on the capital gain. Under the Illinois Taxpayer Bill of Rights, a taxpayer is entitled to attorney fees if a Department position is not supported by reasonable cause. Hercules argued that "reasonable cause" meant "the exercise of ordinary business care" as interpreted under other Illinois tax-related statutory provisions. In response, the Department contended that the Appellate Court should decide whether its position in the earlier dispute was "substantially justified," which is the "reasonable cause" standard applied by the federal courts to the federal statute upon which the Illinois Taxpayer Bill of Rights was modeled.

In ruling for the Department, the Appellate Court held that the agency's decision to tax Hercules was supported by "reasonable cause" regardless of which of the two standards applied. In so ruling, the Appellate Court stated that "the determination of reasonable cause involves review of the legal theory relied upon by the Department to support its action and the facts relied upon by the Department to support that theory." Here, the Department's assessment was based on a valid legal theory and, if satisfied, would have warranted apportionment of the gain in question.

Furthermore, in its first decision relating to this case, the Appellate Court did find that there were some facts supporting the Department's theory of the case and that the Department's reliance on those facts was reasonable. Therefore, the Appellate Court held that the Department had "reasonable cause" to issue the notice of deficiency and denied Hercules' request for attorneys' fees.

Seventh Circuit holds that "Common Management" by a Parent not Enough to make Brother-Sister Companies Unitary

In re: Envirodyne Industries, Inc., 354 F. 3d 646 (7th Cir., Jan. 6, 2004), reh'g denied, 2004 U.S. LEXIS 1182 (Jan. 20, 2004)

The Seventh Circuit Court of Appeals ruled in favor of the Department of Revenue, which had filed a claim in bankruptcy court for additional taxes allegedly owed by Envirodyne Industries, Inc. ("Envirodyne"). The key issue was whether the company's food-packaging and steel businesses constituted a "unitary business group" entitled to file combined Illinois income tax returns. This question arose because the food-packaging business had operations in Illinois (as well as elsewhere) and was profitable, while the steel business had out-of-state operations and generated losses. If permitted to file combined returns, Envirodyne could reduce its tax burden by offsetting the steel company losses against the income from the food-packaging business. However, the Seventh Circuit held that the Envirodyne businesses did not represent a "unitary business enterprise" and that the filing of combined returns was inappropriate.

Envirodyne had several subsidiaries that composed two primary businesses, the food-packaging business and the steel business. The parent company was "actively involved in the management of [each] subsidiar[y]," in addition to providing tax, legal, and accounting services to each subsidiary. The food-packaging and steel businesses, however, did not integrate their operations in any way (e.g., joint advertising, common pension plans, common employee handbook).

The Envirodyne case hinged on the meaning of the phrase "unitary business group." The taxpayer argued that since the food-packaging and steel businesses shared "common management" at the parent-company level, the unitary business group requirement was met. Under this interpretation, the lack of integration between the food-packaging and the steel businesses was irrelevant. The Department, on the other hand, argued that a unitary business requires "genuine integration" at the operating level of the subsidiaries (i.e., that "members of a unitary business group must depend on and contribute to each other").

HMB Comment:
This reading of the unitary business law represented a departure from the "transitive theory" of unity that the Department itself has long advanced. This theory holds that if Company A has a unitary relationship with Company B, and Company B has a unitary relationship with Company C, then the three companies are all engaged in a single unitary business. Under this view, centralized management by a common parent is the hallmark of unity, even though there may be few, if any, functional links between the subsidiary group members.

The Seventh Circuit Court agreed with the Department. Though the Seventh Circuit Court acknowledged certain inconsistencies in Illinois case law on the "unitary business group" topic, it focused on the statutory requirement of "functional integrat[ion]" and used Illinois case law to determine a specific meaning for this term. The Seventh Circuit Court quoted from the Illinois Supreme Court's ruling in *Caterpillar Tractor Co. v. Lenckos*, 417 N.E.2d 1343, 1351 (Ill. 1981):

The term "unitary business group," when applied to a corporation which has subsidiaries … in other States, is used to describe a group of functionally integrated corporate units which are so interrelated and interdependent that it becomes relatively impossible for one State to determine the net income generated by a particular corporation's activities within the State and therefore allocable to that State for purposes of taxation… [emphasis added]

The Seventh Circuit Court held that the food-packaging and the steel businesses of Envirodyne lacked this required "interdependence," as well as other "functional integration" qualities, such as "uniform [business] standard[s]" or "uniform code[s] of conduct for its personnel." The Seventh Circuit Court, therefore, held that the Envirodyne businesses did not constitute a "unitary business group" and that Envirodyne was not entitled to file a combined return.

The Seventh Circuit Court questioned the Department's departure from its normal litigation strategy, which is arguing that centralized management is the hallmark of a unitary business group. Judge Posner stated:

Illinois may be shortsighted in urging a construction of "unitary business group" that requires genuine integration, for that will make it harder for the state to reach out and tax income of affiliates of Illinois firms in other states. But that is a tactical decision for the state to make; it has no bearing on our interpretation and application of the statute.

A Partner's Share of a Partnership's Gain from Selling Substantially All its Assets is Non-Business Income

Shakkour v. Bower, Dkt. No. 99 L 50548 (Ill. Cir. Ct., March 24, 2004), reh'g denied (May 6, 2004), appeal docketed, No. 1-04-1646 (Ill. App. Ct., June 2, 2004)

The Circuit Court of Cook County held that Leila Shakkour, a non-resident of Illinois, was not subject to tax on her pro-rata share of the gain from a partnership's installment sale of substantially all of its assets.

Shakkour held a minority interest in a partnership formed to own trading software and other proprietary trading technologies. In 1992, the partnership sold its assets to Swiss Bank, realizing a substantial capital gain. The partnership postponed dissolution so that it could receive, on an installment basis, payments from the purchaser.

Shakkour reported 100% of her share of the gain on her income tax return filed with her state of residency. She also filed Illinois non-resident income tax returns for the 1994-96 tax years, but reported her share of the gain as non-business income allocable to her state of residency.

The Department of Revenue examined Shakkour's 1994-96 Illinois returns and reclassified her share of the capital gain as business income. The Department issued her a Notice of Deficiency and proposed assessing her taxes and interest of nearly $800,000. Shakkour paid the contested amount under protest and filed a complaint in Circuit Court.

The parties filed cross motions for summary judgment. Shakkour maintained, and the Circuit Court agreed, that the gain was non-business income under *Blessing/White, Inc. v. Zehnder*, 329 Ill. App. 3d 714 (1st Dist. 2002). In that case, the Appellate Court ruled that a gain from an extraordinary liquidation sale does not satisfy either the transactional test or functional test of Illinois' business-income definition when (1) the sale constitutes a cessation of the company's business activities; and (2) the sale proceeds are distributed to the owners, rather than being used to acquire business assets or generate income for use in future business operations.

The Department argued that the partnership's sale of its trading technology was "integral to the taxpayer's regular trade or business operations" (thus satisfying the functional test) because the partnership derived over 80% of its lifetime revenues from the liquidation sale. Specifically, the Department contended that if a partnership is formed for the express purpose of owning an intangible asset, and the sale of that asset generates over 80% of the partnership's total revenues, both the asset and sale would seemingly be integral to the partnership's operations.

The Circuit Court rejected the Department's argument, reasoning that *Blessing/White* and similar out-of-state court decisions hold that if the foregoing two-prong test is met, the functional test fails and the gain is non-business income. The Circuit Court found no basis for expanding the two-prong test to include the additional criteria advanced by the Department to overcome the business income presumption, such as (1) that the asset must be held for a certain term of years prior to sale, or (2) that the gross proceeds from the sale cannot exceed a certain percentage of the asset's lifetime generated proceeds. For these reasons, the Circuit Court concluded that Shakkour was not taxable in Illinois on her share of the gain.

The Department has filed an appeal with the Appellate Court.

Sales Shipped from Illinois to Foreign Countries are not Subject to the "Throwback" Rule When the Seller has Foreign Taxes Withheld on Foreign-Source Income

Morton International, Inc. v. Department of Revenue, Dkt. No. 01 L 50752 (Ill. Cir. Ct., July 8, 2004)

The Circuit Court of Cook County has blocked the Department of Revenue's attempt to increase a chemical maker's sales factor numerator by including receipts from sales of goods shipped from Illinois to purchasers in foreign countries. The general rule is that receipts are included in the sales factor numerator when goods are shipped to a purchaser in Illinois. However, under the "throwback" rule, the sales factor numerator also includes receipts from sales of goods that are shipped from Illinois to a purchaser in a jurisdiction where the seller is not taxable.

Morton shipped salt and specialty chemicals from its warehouse in Illinois to purchasers in foreign countries. Morton also licensed intellectual property to affiliates in these same countries. The Department argued that receipts from Morton's chemical sales should be included in the sales factor numerator under the "throwback" rule because, although Morton paid foreign income taxes on the royalties received from its licensing activities, it did not pay foreign taxes on income from its sales of goods. Thus, the Department argued these sales must be included in the sales factor numerator because, if they are not, Morton would be assigning sales to a jurisdiction where the income from the sales is not taxed.

The Circuit Court agreed that this situation allowed Morton to have "nowhere sales," but emphasized that this was simply a function of the law, which the Circuit Court said allows for this result. Moreover, the Department did not seek to deviate from the statutory formula by asking for alternative apportionment under Act Section 304(f).

The Department did not appeal the Circuit Court's decision.

HMB Comment:
The Circuit Court's decision may provide refund claim opportunities to taxpayers who ship goods from Illinois to purchasers in other jurisdictions.

Subsidiaries Part of Unitary Business Group even though not Engaged in Same Line of Business and No Showing of Vertical Integration

Department of Revenue v. XXXXXXX Cellular Holding, Inc., et al., Department of Revenue, IT 04-7 (Dec. 31, 2003)

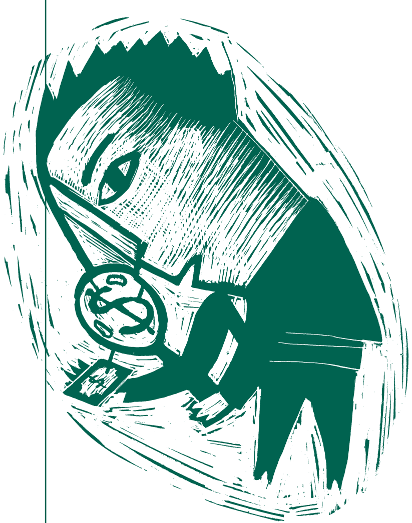
An Administrative Law Judge ("ALJ") has held that a taxpayer and its subsidiaries constituted a unitary business group because they met the functional integration test, notwithstanding that there was no showing that the subsidiaries were engaged in the same general line of business or part of a vertically integrated business operation. Documentary evidence indicating functional integration through strong centralized management included: (1) minutes of shareholder meetings and board meetings for selected subsidiaries; (2) documentation showing control of the subsidiaries' expenses and head count through approval by the taxpayer; and (3) the taxpayer's control over accounting, tax, and legal functions.

The ALJ also held that the taxpayer's Foreign Sales Corporation ("FSC") was properly included as part of the taxpayer's unitary business group. The taxpayer contended that the FSC should be excluded from the unitary business group under the "80/20 rule," which excludes from a unitary business group any company performing more than 80% of its business outside the United States, as measured by payroll and property. Because the FSC had no payroll, the 80/20 test was applied using only a property factor. The taxpayer argued that the FSC met the "80/20 rule" because it paid management fees to a company located in the Virgin Islands for administrative functions and these fees should be construed as "rental fees." However, because there was no evidence that the FSC had possession or control over the purported rental property, the taxpayer failed to prove the FSC rented property outside the United States. Therefore, the FSC was properly included in the taxpayer's unitary business group.

Finally, the taxpayer contended that it was entitled to the investment credit for its aircraft because the applicable statute does not require any specific percentage of use in Illinois, but only requires the aircraft be used in Illinois by a manufacturer. The Department argued that because the aircraft was not used in Illinois more than 50% of the time, the taxpayer failed to demonstrate that it was predominantly used in the State. The ALJ agreed with the Department, even though the aircraft was hangared in Illinois.

Reportable-Transaction Disclosure Requirements and Penalties, 35 ILCS 5/501, 35 ILCS 5/1001(b), 35 ILCS 5/1005, 35 ILCS 5/1007

Effective July 30, 2004, taxpayers are required to file with the Department of Revenue a copy of their disclosure statement under Treasury Regulations Sections 1.6011-4 with respect to reportable transactions, including listed transactions entered into after February 28, 2000.



For transactions in which a taxpayer participated for taxable years ending before December 31, 2004, the taxpayer is required to make its disclosure by the due date (including extensions) of the first return required under the Income Tax Act after this legislation became law. For transactions in which a taxpayer participated for taxable years ending on and after December 31, 2004, disclosure is required to be made in the time and manner as prescribed in Treasury Regulations Section 1.6011-4(e).

Failure to properly disclose a reportable transaction to the Department results in a $15,000 penalty for each failure to comply ($30,000 for listed transactions), subject to abatement for reasonable cause. In addition, if a taxpayer fails to include on any return any information with respect to a reportable transaction, the statute of limitations for issuing deficiency notices is extended from 3 years to 6 years (limited to the non-disclosed item). Further, an understatement of tax due to reportable transactions results in a 20% penalty (30% penalty if the transaction is not adequately disclosed).

The legislation imposes a 100 percent interest penalty if the IRS or the Department has contacted a taxpayer regarding the use of a potential tax avoidance transaction and then has a deficiency with respect to such taxable year or years. However, the interest penalty increases to 150 percent if certain conditions are met. Specifically, for taxable years ending on and after July 1, 2002, for any notice of deficiency issued before the taxpayer is contacted by the IRS or the Department regarding a potential tax avoidance transaction, the taxpayer is subject to interest as otherwise provided by law, but with respect to any deficiency attributable to a potential tax avoidance transaction, the taxpayer is subject to interest at a rate of 150 percent of the otherwise applicable rate.

The legislation also imposes a $15,000 penalty ($100,000 for listed transactions) for failure to register a federal tax shelter or maintain a list of investors in a potentially abusive tax shelter. This penalty may be abated for reasonable cause. The legislation also imposes a penalty for promoting tax shelters, and the penalty is the greater of $10,000 or 50% of the gross income received (or to be received) by the promoter.

Although the failure to disclose reportable transaction penalty under 35 ILCS 5/1001(b), the reportable transaction penalty under 35 ILCS 1005(b), and the 100% interest penalty under 35 ILCS 5/1005(c) are not subject to doubling under Illinois' Tax Delinquency Amnesty Act, the simple interest calculated on any underpayment is still subject to double interest pursuant to 35 ILCS 735/3-2(f).

Tax Shelter Voluntary Compliance Law, 35 ILCS 20/1, *et seq.*

From October 15, 2004 to January 31, 2005, the Department of Revenue is administering a tax shelter voluntary compliance program for eligible taxpayers subject to the Income Tax Act. The program applies to income tax liabilities attributable to the use of tax avoidance transactions for taxable years beginning before January 1, 2004.

"Tax avoidance transaction" is defined as a "plan or arrangement devised for the principal purpose of avoiding federal income tax." Tax avoidance transactions include, but are not limited to, 'listed transactions' as defined in Treasury Regulations Section 1.6011-4(b)(2). Unlike California and New York where there are also state-specific transactions, there are no separate Illinois tax avoidance transactions.

To be eligible to participate, a taxpayer must (i) file an amended return; and (ii) make full payment of the tax and interest due attributable to the tax avoidance transaction. An eligible taxpayer may participate with or without appeal rights. If the taxpayer participates without filing for a credit or refund attributable to the tax avoidance transaction, the Department will abate all underreporting and underpayment penalties. If the taxpayer participates with the right to file a refund claim with respect to the tax avoidance transaction, the Department will abate only Illinois' new 20% reportable transaction penalty and its new 100% interest penalty.

Effective October 18, 2004, the Department issued emergency regulations for the tax shelter voluntary compliance program. See 86 Ill. Admin. Code § 100.9900. Emergency regulations are in effect for a maximum of 150 days.

Business Expenses Recaptured on Sale of Non-Business Assets, 35 ILCS 5/203(e)(3)

Effective July 30, 2004, taxpayers who realize non-business income from the disposition of an asset or business are required to recapture, as business income in the year of disposition, business expenses deducted in the current and two immediately-preceding tax years that were related to the asset or business that generated the non-business income.

Illinois' "Business Income" Definition Expanded to Constitutional Limits, 35 ILCS 5/1501(a)(1)

Effective July 30, 2004, the term "business income" means:

"[a]ll income that may be treated as apportionable business income under the Constitution of the United States. Business income is net of the deductions thereto.... a taxpayer may elect to treat all income other than compensation as business income."

HMB comment: *The new definition of "business income" replaces the "transactional test" and "functional test," but does not affect the annual "business income" election. See 35 ILCS 5/1501(a)(1).*

Interest and Royalty Expense Limitations on Corporate Base Income, 35 ILCS 5/203(b)(2)(E-12), (E-13), (V)-(X)

For tax years ending on or after December 31, 2004, all Illinois taxpayers are required to add-back, in computing their "base income," otherwise allowable deductions for interest expenses and intangible expenses "paid, accrued, or incurred, directly or indirectly, to a foreign person who would be a member of the same unitary business group but for the fact that [the 80/20 rule applies]." The term "foreign person" includes a corporation, foreign or domestic, whose business activity outside the United States is 80% or more of the entity's total business activity. 35 ILCS 5/1501(a)(30). Exceptions to the add-back rule include the following:

(1) the interest or intangible expense is paid to a foreign person who is subject in a foreign country or state, other than a state which requires mandatory unitary reporting, to a tax on or measured by net income with respect to such item;

(2) the interest or intangible expense is paid to a foreign person and the taxpayer can establish that (a) the foreign person during the same taxable year paid the interest or intangible expense to a person that is not a related member, and (b) the transaction giving rise to the interest or intangible expense between the taxpayer and the foreign person did not have as a principal purpose the avoidance of Illinois income tax, and is paid pursuant to a contract or agreement that reflects arm's length terms; and

(3) with respect to interest (not intangible) expenses, the taxpayer can establish that the interest paid relates to a contract or agreement entered into at arm's length rates and the terms and the principal purpose for the payment is not federal or Illinois tax avoidance.

RETAILERS' OCCUPATION (SALES) AND USE TAXES

Court Cases

Car Manufacturer's Incentive Included in the Dealer's Taxable Gross Receipts

Ogden Chrysler Plymouth, Inc. v. Bower, 348 Ill. App. 3d 944, 809 N.E.2d 792 (2nd Dist. 2004), petition for leave to appeal denied, 2004 Ill. LEXIS 1355 (Ill. S. Ct., Oct. 6, 2004)

The Appellate Court reversed a lower court determination and ruled that payments made by Chrysler to a Chrysler dealership as part of Chrysler's employee/retiree new vehicle purchase/lease program are subject to sales tax.

Chrysler made the payments in question to Ogden Chrysler Plymouth ("Ogden Chrysler"), an Illinois dealership, under a Chrysler program that enables Chrysler employees and their families to purchase vehicles at reduced prices. As part of the program, Chrysler pays dealerships a fee equal to 6% of the price paid by the employee for a vehicle, plus $75. Ogden Chrysler argued that these payments were not taxable gross receipts.

The Appellate Court rejected Ogden Chrysler's arguments. The Appellate Court concluded that Chrysler's payments were taxable because the payments could be tied to specific sales made by Ogden Chrysler. Further, the Appellate Court found that the dealership's accounting method is irrelevant in determining whether payments are taxable gross receipts. Thus, according to the Appellate Court, the fact that the payments were made in order to reduce Ogden Chrysler's cost of goods sold was not relevant.

The Appellate Court also rejected Ogden Chrysler's claim for attorneys' fees. Ogden Chrysler had requested attorneys' fees on the grounds that the Department's position in this matter, which was reflected in a series of long-standing private letter rulings, amounted to a "rule" for purposes of the Administrative Procedures Act, and that the rule was not promulgated in accordance with that law. The Appellate Court disagreed, concluding that the Department was merely interpreting a statute, not adopting a "rule."

HMB Comment:
The Wisconsin Tax Appeals Commission also recently concluded that payments made by a manufacturer to a dealer as part of an employee purchase program are subject to sales tax. Braeger Chrysler Plymouth Jeep Eagle, Inc. v. Wisconsin Department of Revenue, WTAC No. 02-S-213 (Oct. 12, 2004).

Court Declares that Illinois' Taxation of Line Haul Tugboats Violates the Commerce Clause of the United States Constitution

American River Transportation Company v. Bower, 351 Ill. App. 3d 208, 813 N.E.2d 1090 (2nd Dist. 2004), petition for leave to appeal denied (Ill. S. Ct., Nov. 24, 2004)

The Appellate Court held that Illinois' imposition of use tax on fuel and supplies loaded onto line haul tugboats outside the State violated the Commerce Clause of the United States Constitution. The tugboats spent at least 50% of their time pushing barges in Illinois waters, but the tugboats never docked at any Illinois port. In reaching its decision, the Appellate Court relied on the four-prong test set forth by the U.S. Supreme Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) and held that the tax failed the fourth prong of that test because the tax was not fairly related to the services provided by the State.

The Department argued that Illinois statutory law provided the tugboats with protection from polluted waterways and protection of aquatic life, which was a sufficient benefit provided by the State. The Appellate Court rejected this argument and stated there is no fair relation between the use tax and the benefits received from the State on navigable waters of the United States. In determining that the tax was unconstitutional, the Appellate Court distinguished cases involving out-of-state retail establishments that use trucks to deliver products in Illinois. These retailers received the benefits of the State's public roads, police protection, and judicial system, as well as other benefits conferred by "the maintenance of a civilized society." Here, the benefits provided to the line haul tugboats fell short of the benefits provided to the trucks of out-of-state retailers.

HMB Comment:
This case gives new hope to taxpayers. Prior to this case, there was no precedent for declaring that a tax violates the United States Commerce Clause because the tax is not fairly related to services provided by the State.

Separately Stated "Delivery Charges" are Subject to Retailers' Occupation Tax if they are Part of the "Selling Price"

Stark Materials Company, Inc. v. Illinois Department of Revenue, 349 Ill. App. 3d 316, 812 N.E.2d 362 (4th Dist. 2004)

The Appellate Court held that separately stated "delivery charges" on a ready-mix company's invoices were subject to sales tax because the delivery charges were not separate and apart from the selling price. Stark Materials is an Illinois corporation that mined, excavated, processed, and sold certain minerals as ready-mix concrete. At least one of Stark Materials' customers had the option of having the ready-mix delivered by Stark Materials or picking up the ready-mix from a Stark Materials' location. Regardless of whether the customer picked up the ready-mix or had the ready-mix delivered, Stark Materials' invoices included a "delivery charge." The "delivery charge" was based on a formula that accounted for weighted variables, including operating costs, payroll costs, truck rental costs, fuel charges, plant maintenance costs, and union dues.

Stark Materials argued that the "delivery charges" were not "gross receipts" for sales tax purposes because delivery charges are not taxable if the customer has the option to pick up the product and the delivery charges are separately stated. The Appellate Court rejected these arguments and stated that the delivery charges were part of the selling price because the charges did not reflect the costs of delivery and the "delivery charge" was imposed on all invoices, even if the customer picked up the ready-mix.

The facts of this case were unusual. Unlike most ready-mix buyers, at least one of the buyers in this case owned a ready-mix truck and, therefore, had the option of picking up ready-mix from Stark Materials. Although this would seem to fall squarely within the Department's regulation excluding delivery charges from tax, the Appellate Court questioned whether the charges in issue were, in fact, valid delivery charges.

Qui Tam "Whistleblower" Cases

A group of trial attorneys has sued more than 50 online and catalog retailers under the Illinois Whistleblower Reward and Protection Act, alleging that the retailers' non-collection of use tax from their Illinois customers constitutes civil fraud. The Illinois Attorney General has joined in the litigation on behalf of the State. Several of the retailers have joined forces and filed a joint motion asking the Circuit Court of Cook County to dismiss the actions.

Circuit Court has Jurisdiction over Proper Situs of Retail Sales

The Village of Itasca v. The Village of Lisle and Environetx, LLC, 817 N.E.2d 160 (2nd Dist. Ill. App. Ct., Oct. 12, 2004)

The Appellate Court held that Itasca did not have standing to invalidate a sales tax rebate agreement between Lisle and a retailer because invalidating the agreement would not change how the retailer reported the site of its sales. However, the Court did have jurisdiction to determine whether the retailer falsely reported the site of its sales because the legislature did not vest the Department with exclusive jurisdiction over this matter. Finally, the Court dismissed Itasca's claim for tortious interference with prospective economic advantage against Lisle because Itasca could not establish a reasonable expectancy of entering into a valid business relationship.

HMB Comment:
Certain sales tax rebate or sharing agreements are now conditionally prohibited under a newly adopted law (see discussion pg. 12). The new law also affirms that the circuit court has jurisdiction to hear these types of cases.

Graphic Arts Machinery and Equipment Exemption Reinstated, 35 ILCS 105/3-5(6)

Illinois has re-adopted sales and use tax exemptions for purchases of graphic arts machinery and equipment beginning on September 1, 2004. The State had previously revoked this exemption effective July 1, 2003. The reinstatement of this credit is not retroactive, so a gap period exists from July 1, 2003 through August 31, 2004.

Manufacturers' Purchase Credit Reinstated, 35 ILCS 105/3-85

Illinois has re-adopted its manufacturers' purchase credit. This credit is a percentage of the amount of State sales tax avoided upon purchasing tax-free manufacturing and graphic arts machinery and equipment. The credit is reinstated for a purchaser making such machinery and equipment purchases on and after September 1, 2004. The State had previously revoked this exemption effective June 30, 2003. The reinstatement of this credit is not retroactive, so a gap period exists from July 1, 2003 through August 31, 2004.

New Tax: Watercraft Use Tax law, 35 ILCS 158/1 et seq.

Illinois has adopted a 6.25% tax on the purchase price of watercraft for the privilege of using, in Illinois, any watercraft acquired by gift, transfer, or purchase after September 1, 2004. The term "watercraft" is defined to mean all watercraft 16 feet in length or more, and personal watercraft such as jet skis and wave runners. The term "watercraft" does not include canoes, kayaks, and watercraft less than 16 feet in length.

HMB Comment: *Illinois also has special use taxes for motor vehicles and aircraft. The effect of these rules is that vehicle, aircraft, and now watercraft purchases are taxable to the purchaser even if the occasional sale rule would otherwise apply.*

Commercial Distribution Fee Revised, 35 ILCS 105/3-5(33); 35 ILCS 120/2-5(12-5); 625 ILCS 5/3-815.1; Illinois Dep't of Rev. Info. Bulletin No. FY 2005-02 (July 1, 2004)

The commercial distribution fee is imposed on vehicles of the second division with a gross vehicle weight that exceeds 8,000 pounds and which incur any tax or fee under 625 ILCS 5/3-815 or 5/3-818. The commercial distribution fee sales tax exemption commenced on July 1, 2003. Effective November 3, 2004, the Department requires that a vehicle must be used primarily for a commercial purpose to qualify for this exemption. The commercial distribution fee sales tax exemption is repealed for all vehicles effective July 1, 2005. Also effective June 30, 2004, the commercial distribution fees have been lowered. For registration years before July 1, 2005, the commercial distribution fee is 36% of the taxes and fees incurred pursuant to 625 ILCS 5/3-815 or 5/3-818. From July 1, 2005 through June 30, 2006, the rate is reduced to 21.5%, and on or after July 1, 2006, the rate is reduced to 14.35%.

Sales Tax Rebate Prohibition, 55 ILCS 5/5-1014.3; 65 ILCS 5/8-11-21

Effective June 1, 2004, Illinois law bars local governments from entering into agreements to share or rebate any portion of sales taxes if

(1) the tax on sales of a retailer located in the city would have been paid to another unit of local government, and

(2) the retailer maintains a retail location or warehouse in the other unit of government.

The law also allows local governments that have been harmed by a violation of this new law to file an action in circuit court against the offending local government.

Rolling Stock Exemption Expanded, 35 ILCS 105/3-61(c)

Beginning July 1, 2004, the definition of "use as rolling stock moving in interstate commerce" means motor vehicles that, during a 12-month period, have carried persons or property for hire in interstate commerce for more than 50% of their total trips for that period or more than 50% of their total miles for that period. Formerly, this definition included only motor vehicles that, during a 12-month period, had carried persons or property for hire in interstate commerce for 51% of their total trips.

MISCELLANEOUS

Unclaimed Property

Dividends Issued on Stock held by the State as Unclaimed Property are still Private Property of the Owner and not subject to Forfeit

Canel v. Topinka, Dkt. No. 96755, 2004 Ill. LEXIS 1036 (Ill. S. Ct., Oct. 7, 2004)

The Supreme Court has held that dividends declared on shares of stock, while presumed abandoned and delivered to the Department of Financial Institutions under the Uniform Disposition of Unclaimed Property Act, were property of the owner of the stock and could not be taken by the State without just compensation.

After learning of the remittance of his 288 shares of corporate stock to the State, Canel submitted a claim with the Illinois' Treasurer's Office for the return of his stock and all dividends declared while the stock was in the State's custody. The State returned Canel's stock, but refused to return the dividends issued on the stock. The State argued that the applicable statute did not require the State to return income accrued on unliquidated stock and that the State had ownership rights on this future income. Canel argued that the unclaimed property law only gives the State custodial rights over the property presumed abandoned and that the State does not take title to presumptively abandoned property or any earnings on that property.

The Supreme Court noted that shares of stock in a corporation represent the owner's proprietary interests in the corporation, including management or control rights, rights to earnings, and rights to assets. Once a dividend is declared, it becomes a corporate debt owed to the shareholders in proportion to their shares in the corporation, and, if the corporation refuses to pay, the shareholders may sue to recover the unpaid dividend. Therefore, at all times the stock remained the private property of Canel and, as an incident of ownership, the dividends were also the private property of the owner.

In view of its conclusion, the Supreme Court remanded this case to the Circuit Court for a determination of just compensation. In reaching its decision, the Supreme Court limited its findings to dividends earned on shares of unliquidated stock while in the State's custody pursuant to the unclaimed property law.

Protest Monies Act – Procedure

Consumer has no Standing to Protest Sales Tax Imposed on Distributors and Manufacturers

Wexler v. Wirtz Corp., 211 Ill. 2d 18, 809 N.E.2d 1240 (April 1, 2004)

The Supreme Court ruled that a plaintiff lacked standing to challenge a liquor tax under the Protest Monies Act. The plaintiff sought to contest an increase in the Illinois liquor tax by purchasing a bottle of Smirnoff vodka at Evanston First Liquors. At the time of the purchase, he presented a protest letter to the sales clerk. He then filed a lawsuit challenging the constitutionality of the increased liquor tax.

The Supreme Court ruled that the plaintiff did not have standing to challenge an increased state liquor tax via the Protest Monies Act. The Supreme Court noted that Illinois levied the tax on alcohol on importing distributors and manufacturers, not on the retail purchaser. The Supreme Court stressed strict conformity with the Protest Monies Act requirements and held that the plaintiff lacked the requisite injury needed for standing because as a retail purchaser of alcohol, he was not a "taxpayer" as required by the statute.

In ruling against the plaintiff, the Supreme Court also emphasized the importance of strictly complying with the statutory requirements of the Protest Monies Act. The Supreme Court noted that (a) the true taxpayer must make the protest payment; (b) the tax under protest must be paid to the taxing authorities; and (c) the protest letter must include the specific dollar amount protested, as well as the name and address of the person protesting. When the plaintiff purchased the Smirnoff vodka and presented a letter of protest to the sales clerk, he failed to meet these requirements.

HMB Comment:
This case should be contrasted with Milwaukee Safeguard, et al v. Selcke, 754 N.E.2d 349 (1st Dist. Ill. App. Ct. 2001) where the Appellate Court ruled that a group of insurance companies were not entitled to a premiums tax refund unless they could prove that they bore the burden of the tax and did not pass it on to their policyholders.

Paid-In Capital must be Increased by Fair Market Value in Reverse Triangular Merger

USX Corp. v. White, No. 1-00-3333, 2004 Ill. App. LEXIS 183 (1st Dist., March 1, 2004)

The Appellate Court addressed the franchise tax consequences of a reverse triangular merger and concluded that USX's taxable paid-in-capital must be increased by the fair market value of the target corporation's stock received in exchange for shares of USX stock issued to the target's former shareholders.

To acquire the stock of Texas Oil and Gas Corp., USX created a wholly-owned, limited purpose subsidiary, XCO. USX, Texas Oil and Gas, and XCO entered into a reverse triangular merger agreement whereby XCO merged into Texas Oil and Gas with Texas Oil and Gas as the survivor. The shareholders of Texas Oil and Gas received shares of newly issued USX stock in exchange for relinquishing their ownership of Texas Oil and Gas. At the time of the merger, Texas Oil and Gas' shares were worth $2.9 billion while its historical paid-in-capital was approximately $816 million. The question for the court was whether USX's paid-in-capital should be increased by the fair market value of the Texas Oil and Gas shares – $2.9 billion – or by the historical paid-in-capital of Texas Oil and Gas – $816 million.

USX argued that it was entitled to use the lower figure because of an exception in the Business Corporation Act for statutory mergers. Under the Act, if a foreign corporation is the party to a statutory merger and is the surviving corporation, then the surviving corporation, in determining its resulting paid-in-capital for franchise tax purposes, adds the historical paid-in-capital of the disappearing corporation(s) to its own historical paid-in-capital. If this exception applied, then USX's paid-in-capital would increase by $816 million, not $2.9 billion.

The Appellate Court concluded that the statutory exception did not apply. First, the Appellate Court found that the statutory exception applied only to "horizontal" mergers where one corporation survives, and not mergers like a reverse triangular merger where multiple entities survive. Further, even if USX's interpretation of the statute was correct, the Appellate Court noted that USX was not the "surviving corporation" within the meaning of the statute. According to the Appellate Court, only Texas Oil and Gas was identified as the "surviving corporation" in the certificate of merger. Thus, because the exception did not apply, USX was required to increase its paid-in-capital by the $2.9 billion fair market value of the Texas Oil and Gas stock that it received in exchange for the shares issued to the former shareholders of Texas Oil and Gas.

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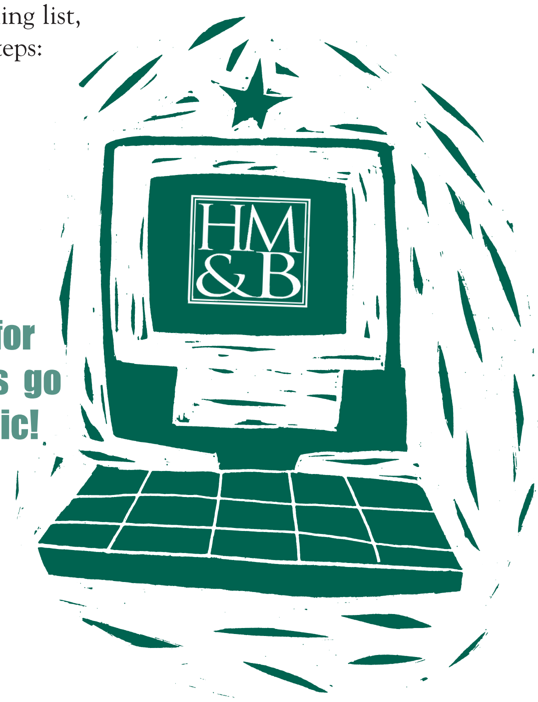

Horwood Marcus & Berk Appointed to Chicago Department of Revenue Practitioner Liaison Committee

The City of Chicago Department of Revenue has invited Horwood Marcus & Berk to join its newly-formed practitioners' liaison committee. At its first meeting, the advisory group discussed proposed tax ordinances, real property taxation, and the Department's license hold and enforcement procedures and online filing and payment initiatives. Feel free to contact us with questions concerning the advisory group.

Circuit Court Holds Fund Surcharge in Budget Implementation Act Unconstitutional

Illinois State Chamber of Commerce v. Filan, Dkt. No. 04 CH 06750 (Ill. Cir. Ct. Nov. 29, 2004)

The Cook County Circuit Court held that the Industrial Commission Operations Fund Surcharge, which was established by the Illinois 2004 Budget Implementation Act, violated both the Uniformity Clause and the Due Process Clause of the Illinois Constitution. The surcharge was imposed on employer's premium insurance charges for their liabilities arising under the Workers' Compensation Act or the Workers' Occupational Disease Act at the rate of 1.5% of the insurance companies' direct premium. In addition, self-insured employers were charged an annual Industrial Commission Operations Fund Fee at the rate of 0.045% of those employers' annual wages.

Under the Uniformity Clause, all classifications of subjects or objects taxed or against whom fees are assessed must be reasonable and all entities within the reasonable classification must be taxed uniformly. According to the Court, the Fund Surcharge violated the Uniformity Clause because the classification of fee payers was not reasonable and because the fee did not relate to the anticipated cost of operating the Industrial Commission. First, the fees were assessed against approximately 1,500 fee payers. About 1,200 of the fee payers were designated as "non-burdened" fee payers and assessed a sum that either equals or is less than the cost incurred by the State regulatory activity. However, the other 300 fee payers were designated as "non-consumer" fee payers and were required to pay fees intentionally set in an amount to generate far more revenue than required to defray the costs of the regulatory activities conducted by the State. Indeed, the sub-groups were created to raise revenue from the 300 selected fee payers believed most able to pay. The Court found that there was no justification for the classifications.

In addition, the fee did not relate to the anticipated cost of operating the Industrial Commission. The Court distinguished between a fee, which is a charge fixed by law for services of public officers, and a tax, which is a charge having no relation to the services rendered. Although designated as a "fee" under the statute, the Industrial Commission Operations Fund Surcharge generated more than twice the revenue needed to operate the Industrial Commission. In addition, the resulting surplus was clearly anticipated in the Budget Implementation Act because the Director of the Bureau of the Budget was granted additional powers to allocate the surplus collected.

The Court found that the Fund Surcharge also violated the Due Process Clause of both the federal and state constitutions because it infringed on a fundamental right. Here, both employers and employees were required to bring all injury claims to the Industrial Commission. The Court held that where fees are imposed, not to fund the administration of justice, but rather to support unrelated programs, the fees become an impermissible tax on litigation and violate the Due Process Clause.

HMB Comment:
Although the Circuit Court held that only the Industrial Commission Operations Fund Surcharge was unconstitutional, many other fees, including the commercial distribution fee, may provide refund opportunities for fee payers subject to the new and increased fees.

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Appellate Court Reverses Circuit Court, Reinstates Penalty Assessment

Hollinger International, Inc. v. Glen L. Bower, Director of Revenue, Dkt. No. 1-04-0392 (1st Dist. Ill. App. Ct., Dec. 27, 2004)

The Circuit Court of Cook County reversed an administrative law judge's ("ALJ") determination that Hollinger International, the publisher of the *Chicago Sun Times*, did not have reasonable cause for underestimating two quarterly income tax installments or for making one quarterly installment payment after it was due.

The Income Tax Act allows corporations like Hollinger to pay their income taxes in quarterly installments based on either what they owed in the prior year or what they estimate they will owe at the end of the current year. The Department of Revenue proposed assessing Hollinger with two penalties in connection with installments the publisher made in 1998—one because the company underestimated its installments for the first two quarters, and the other because the company was (allegedly) late in making its installment for the third quarter.

Hollinger argued before the ALJ that it should not be penalized for underestimating its payments for the first two quarters because the publisher relied on its trusted, long-time CPA firm to perform the payment calculations, and that it should not be penalized for the late payment for the third quarter because the only reason the installment was late was that the corporate finance manager miscopied a single ZIP code digit on the payment envelope.

The ALJ rejected both arguments. Specifically, the ALJ found that Hollinger did not reasonably rely on its accountant to compute the tax installments because, the ALJ suggested, the accountant was only minimally qualified for the job in the first place, and because the estimates were destined for error all along since, the ALJ insinuated, Hollinger knowingly supplied the accountant with incomplete or otherwise unreliable background figures. The Circuit Court reversed the ALJ on this issue on the ground that the ALJ's finding lacked even the pretense of evidentiary support.

The ALJ found that Hollinger did not show ordinary care in mailing the installment for the third quarter in that there was no documentary proof supporting the corporate finance manager's testimony that he put the payment envelope in the company mail before the due date. The Department's policy on late-payment penalties is that a taxpayer's filing history deserves weight, and that the penalty should not apply if the taxpayer fails to pay its taxes on time because of an isolated error or some other honest mistake. Ill. Admin. Code tit. 86, § 700.400(d), (e)(7). The Circuit Court reversed the ALJ on this issue too because, the Circuit Court concluded, the Department's trial counsel failed to rebut the testimony of Hollinger's manager that the ZIP code error was an honest mistake, and because the ALJ ignored evidence that Hollinger had never before been late in making its quarterly tax installments.

The Department appealed the Circuit Court's reversal of the penalty for underestimating the two quarterly income tax installments, but did not appeal the reversal of the late payment penalty. On December 27, 2004, without granting the parties' request for oral argument, the Appellate Court reversed, finding that the ALJ did not err in refusing to abate the penalty assessment. It is not known whether Hollinger will petition for rehearing.

HMB Comment:
If upheld, the Appellate Court's opinion could have serious implications for corporate taxpayers who engage outside professionals to calculate their Illinois estimated income tax payments and prepare their Illinois income tax returns.

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