

**IDOR Practitioners Meetings  
January 27 and 29, 2010  
Questions and Answers**

**Income Tax**

1. Regarding the new Michigan Business Tax (MBT) - there are two parts: the Gross receipts tax plus surcharge and an income tax plus surcharge. Is the Gross receipts tax plus surcharge a deductible expense for the IL business returns? How does Illinois handle the MBT?

**Response:**

**The Illinois income tax treatment of Michigan Business Tax follows the federal income tax treatment.**

**Under Section 203 of the Illinois Income Tax Act (35 ILCS 5/203), the computation of a taxpayer's "net income" taxed by Illinois begins with the taxpayer's federal taxable income or, in the case of an individual, adjusted gross income, as properly computed for the taxable year. Various addition and subtraction modifications are then made, and the resulting "base income" is then allocated and apportioned to Illinois. Section 203(h) provides that no modification may be made to taxable income or adjusted gross income unless expressly provided in Section 203.**

**Section 203 provides that all Illinois income tax and replacement tax deducted in computing federal taxable income or adjusted gross income must be added back. Section 203(c)(2)(F) requires a resident trust to add back any federal deduction it claimed for an income tax paid to another state, if it is claiming an Illinois credit for that tax. Otherwise, Section 203 does not require the add-back of any tax deducted on the taxpayer's federal return. There is no subtraction for any tax that is not deducted in computing federal taxable income or adjusted gross income.**

2. As a taxpayer we received a notice disallowing a Distributive Share of Subtractions received by our QSSS on the Parent's return due to different FEIN numbers. The Distributive share of Additions was allowed. How should a taxpayer handle this situation? What steps, if any, has Illinois taken when there are multiple levels of flow-thru entities?

**Response:**

**To show its entitlement to the flow-through subtractions, the parent should send a letter explaining that a qualifying Subchapter S subsidiary (QSSS) election has been**

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made, so that the subsidiary's separate existence is disregarded, and attach a copy of the federal Form 8869 it filed with the IRS to make the QSSS election. If there is a chain of corporations that have made the QSSS election, copies of the Forms 8869 for each should be attached to a letter tracing the connection between the subsidiary that received the pass-through subtractions and the parent.

### **Electronic Filing/Tax Return Processing**

3. Is the Department going to change the filing due date for ST-1 forms? The 20th day of each month is a burden on clients and tax preparers to get this done on time, especially in quarterly months.

#### **Response:**

**No. There have been no discussions to change the due date from the 20<sup>th</sup> day of the month following the liability period for which a return is filed.**

4. Does the Department have any plans to offer e-filing for entity (1120S, 1120, 105) income tax returns?

#### **Response:**

**The department has for the period of time been working with the FTA and software companies to develop an e-filing application for the 1120. Testing is scheduled later this year with a possibility of having an application available 2011. No plans are in place for the 1120-ST at this time. I have no knowledge of a 105 income tax form.**

5. We are seeing "Return Correction Notice" issued to our clients with refunds of under \$5. Why is IL wasting 3 pages of paper and getting taxpayers anxious with such notices when it is a refund of interest and penalty amounts that differ on filed vs IL calculation amounts? Also, IL seems to be using cents rather than rounded dollars in their interest/penalty calculations now which are creating some of the notices.

#### **Response:**

**What the taxpayers may see are the end or net result of an adjustment. In any event the RCN is not a bill and anytime we make adjustments to a taxpayers signed return we are obligated to inform the taxpayer. It is the right thing to do.**

Preparers do not want "notices" going to clients as clients get anxious and think WE as preparers did something wrong when filing the returns.

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**Response:**

**Our obligation is to the taxpayer.**

As to the notice that is used, the As Corrected column has the IL numbers but then there is just a brief explanation column. The explanation does not indicate the change but rather what that number currently is. The 3<sup>rd</sup> page then gives detail of the Penalty calculations; I had a taxpayer wonder if he needed to pay this new penalty amount in total. And the latest notice I got had most of the calculation difference in Interest and that item did not have an explanation next to it. There is no AS FILED column; if there was, the taxpayer would see how close the filed numbers were and would not have much issue with the change. As it currently exists, the taxpayer really has no idea what number was wrong.

**Response:**

**We would need to see the notice and the associated tax. Much is being done to make our notices clearer and more concise. The Business Tax Division currently has requests (SQRs) in to address many of the issues for which we have been receiving comments. The practitioner should send a copy of the RCN to the attention of Wayne Richie with their comments.**

**Sales/Use Tax**

6. Company A buys a large machine from an affiliate in State X (a state other than Illinois). Assume for purposes of this question that this purchase that this purchase would be taxable, except for the isolated and occasional exemption that State X has in its sales and use tax statutes. Also assume that if Company A received this machine in Illinois, and not State X, the Illinois isolated and occasional sale provisions would have also applied, exempting this sale from the Illinois tax.

Company A uses the machine in State X for a year. At that time, Company A's operations in Illinois require the machine. The machine is subsequently shipped to Company A's location in Illinois where it is used in Company A's operations. Since the purchase of the machine was exempt, and would have been exempt if purchased in Illinois, or shipped to Illinois when purchased, is Illinois use tax due at the time the machine is subsequently brought into and used in Illinois? Please explain your answer. Assume that no other state exemption applies (such as a machinery and equipment exemption, exempt entity, etc.). Also, please note if the answer would be different if the original purchase, while still qualifying as an occasional sale, was not made from an affiliate.

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**No Illinois Use Tax would be due, under the circumstances described above and the assumptions that have been made in order to answer this question. For purposes of our response, we assume that the affiliate purchased the machine for the purpose of use and not for the purpose of resale, and that the affiliate is not in the business of selling these types of machines.**

**Section 1 of the Retailers' Occupation Tax Act provides that the "isolated or occasional sale of tangible personal property at retail by a person who does not hold himself out as being engaged (or who does not habitually engage) in selling such tangible personal property at retail ... does not constitute engaging in a business of selling such tangible personal property at retail within the meaning of this Act ..." 35 ILCS 120/1. Section 2 of the Use Tax Act, 35 ILCS 105/2, contains similar provisions exempting items purchased through occasional sales. Regulations at 86 Ill. Adm. Code 130.110 further explain these provisions.**

**As a result, because the affiliate is not in the business of selling these machines, and is instead merely selling a machine that it no longer uses in its business, it does not incur Retailers' Occupation Tax on the sale of the machine to Company A. The affiliate incurs no Retailers' Occupation Tax on its sale and the purchaser likewise incurs no Use Tax on its purchase, based on the occasional sale exemption.**

**The fact that Company A brings the machine into Illinois for use does not change the outcome. As the questioner points out, Use Tax would normally be due when an item is brought into Illinois for use. However, no Use Tax is due in this situation because the purchaser obtained the machine as part of an occasional sales transaction. Section 3-65 of the Use Tax (35 ILCS 105/3-65) provides that if a seller of tangible personal property for use would not be taxable under the Retailers' Occupation Tax Act despite all elements of the sale occurring in Illinois, then the tax imposed by the Use Tax does not apply to the use of the tangible personal property in Illinois. As indicated above, were the affiliate's sale of the machine to have occurred in Illinois, it would be deemed an occasional sale. Under Section 3-65, as explained above, since there would be no ROT liability on this transaction, there is also no Use Tax liability on the machine when it is brought into Illinois for use.**

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