

IT 98-1

Tax Type: INCOME TAX

Issue: Income Earned In Illinois/Individual Residency

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
CHICAGO, ILLINOIS**

**JANE M. DOE and RONALD A. ROE,
as personal representatives for the
Estate of Richard Somebody, Deceased,
et al.,**

Petitioners

v.

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

No. 95-IT-0000

**Linda K. Clffel,
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Rex A. Guest of Katten Muchin & Zavis, for Jane M. Doe & Ronald A. Roe, as personal representatives for the Estate of Richard Somebody; Sean Cullinan, Special Assistant Attorney General, for the Illinois Department of Revenue.

SYNOPSIS:

Taxpayers¹ did not file Illinois income tax returns for the 1984 and 1985 tax years. On audit, the Department made the determination that certain capital gains, related to an Illinois company, reported by the taxpayers on their federal return were Illinois income. Taxpayers paid the tax assessed and filed claims for refund. This matter concerns the claims.

¹ The petitioners in this case are the estates of the taxpayers, Richard and Mary "Somebody". "Taxpayers" will refer to the "Somebody"s, not their estates.

There are two issues here. One, is whether the taxpayers were Illinois residents, and two, if they were not residents, whether the capital gains related to the liquidation of XYZ Supply Company (“XYZ”) should be situated in Illinois and subject to Illinois income tax.

FINDINGS OF FACT:

1. Richard and Mary “Somebody”² filed joint federal income tax returns for the tax years 1984 and 1985 as well as amended returns for 1984. (Taxpayer Ex. Nos. 24 through 26)

2. The address on the original federal 1040 filed for 1984 showed an address of 1111 Anywhere Road, Shady Lane, Illinois. This address was the location of XYZ, and was in an industrial park, not a residential area. (TRFA³ Ex. C) Both the amended 1984 and the 1985 federal tax return showed an address of 3333 Tropical Place, Somewhere, Florida. (Taxpayer Ex. Nos. 24 through 26)

3. Taxpayers filed no Illinois income tax returns for 1984 and 1985. As a result of a tape match with the Internal Revenue Service which showed taxpayers filed their 1984 federal income tax return with an Illinois address, the taxpayers were investigated by the Illinois Department of Revenue Bureau of Criminal Investigation (“BCI”). After an investigation of the matter, BCI found that prosecution was not warranted, but referred the case to the Office Audit Programs Unit who proposed the assessments against the taxpayers. (TRFA Ex. C)

4. Michael Hoff of BCI wrote a letter to the taxpayers dated July 12, 1990 which stated “It is understood that you were legally a Florida resident during this period but because Illinois income was derived, you are liable for Illinois Income Tax regardless of residency.” (Taxpayer Ex. No. 16)

² While the bulk of the residency evidence introduced relates to Richard “Somebody”, there has been no suggestion by any of the parties that Mary “Somebody” resided apart from Richard “Somebody” and therefore my findings regarding Mr. “Somebody” should apply with equal weight to Mrs. “Somebody”.

5. Taxpayer's counsel received a letter from Rebecca A. Smith, Revenue Auditor III, dated July 29, 1993, which indicated in part that the Department of Revenue would not challenge taxpayers' claim that they were residents of Florida in 1984 and 1985. (TRFA Ex. B)

6. The Department issued a Notice of Deficiency ("NOD") to taxpayers on March 28, 1991. (Taxpayer Ex. No. 3) Taxpayers failed to timely protest the NOD, so that the NOD became a final assessment. (Dept. Ex. No. 3) Taxpayers paid \$222,088.89 in tax, penalties and interest for 1984, and \$9,501.70 in tax, penalties and interest for 1985. Taxpayers filed a claim for refund for the total amount paid on January 5, 1995. (Taxpayer Ex. No. 4) The Department issued a Notice of Denial ("Denial") for the full amount of the claim on October 20, 1995. (Taxpayer Ex. No. 6) Taxpayers timely protested the Denial on November 14, 1995. (Taxpayer Ex. No.7)

7. Taxpayers had homes in Florida and Illinois during these tax years. In Florida they owned a condominium at 3333 Tropical Place, Somewhere. In Illinois they owned a house at 1234 Fictitious Lane, Some Suburb. (TRFA Ex. C, D; Dept. Ex. No. 9)

8. Richard filed a petition for dissolution of marriage in Cook County on March 25, 1985, which, under penalties of perjury, stated that he was currently a resident of Cook County. The petition stated that the marital residence was located at 1234 Fictitious Lane, Some Suburb, Illinois, and included marital property of a vacation home in Somewhere, Florida. (Dept. Ex. No. 9)

9. Richard "Somebody" signed a Declaration of Domicile signed October 16, 1992 indicating that he became a resident of Florida on January 10, 1984, residing at 3333 Tropical Place, Somewhere, Florida, and that he was formerly a legal resident of 1234 Fictitious Lane, Some Suburb, Illinois. (TRFA Ex. D)

³ TRFA refers to Taxpayers Request for Admissions which were not responded to by the Department and therefore are deemed admitted.

10. Richard "Somebody" executed an affidavit dated September 4, 1991 at the request of the Department of Revenue stating he was a resident of Florida during 1984 and 1985. (TRFA Ex. No. E)
11. Neither Richard nor Mary "Somebody" filed a Florida intangibles tax return in Florida during these tax years. (Dept. Ex. No. 7)
12. Richard "Somebody" was registered to vote in Dade County, Florida from October 3, 1985 until his death. (Taxpayer Ex. No. 9)
13. Richard "Somebody" obtained a Florida driver's license in 1977. (Taxpayer Ex. No. 12) Mr. "Somebody" also maintained an Illinois driver's license from March 12, 1976 to the date of expiration, March 23, 1996. Mary "Somebody" also had an Illinois driver's license which was issued May 26, 1981 and expired May 25, 1995. (Dept. Ex. No. 10)
14. Taxpayers died on January 23, 1996. (Taxpayer Ex. Nos. 1, 2)
15. Letters of Administration were issued to Jane M. Doe and Ronald A. Roe to act as personal representatives of the Estate of Richard "Somebody". (Taxpayer Ex. No. 1) Letters of Administration were issued to Betty Crocker to act as personal representative of the Estate of Mary "Somebody". (Taxpayer Ex. No. 2)
16. Melissa Manpower, taxpayers' niece, testified that the taxpayers' condominium was approximately 2800 square feet in area with two bedrooms, a den, kitchen, living room and an office area. She also testified that the kitchen was fully stocked and that Mr. "Somebody" kept his computer and paperwork in his office there. (Tr. p. 50)
17. Mrs. "Somebody" had relatives residing in Florida: her sister, DeeDee, and her husband lived in Miami and Lake Placid. Prior to her death, Mrs. "Somebody"'s mother resided in Florida. (Tr. pp. 52-53)

18. Mr. “Somebody” had a brother, Bro, who resided in Florida. (Tr. p. 53)

19. XYZ was a plumbing supply company located in Illinois. The sole shareholders were Richard and Mary “Somebody”. (Taxpayer Ex. No. 21)

20. XYZ was liquidated pursuant to a plan of liquidation under Section 337 of the Internal Revenue Code.⁴ (Taxpayer Ex. No. 18) Accordingly, XYZ entered into an agreement with AAA Corp. for the sale of certain of XYZ’s assets consisting of machinery, equipment, furniture, fixtures, trucks and inventory as well as a transfer of the name “XYZ Supply Company.” The purchase price of the assets of \$1,387,144.40 was payable in equal monthly installments of \$29,645.93 with interest at a rate of 9% commencing May 15, 1984 and continuing the 15th day of each succeeding month for a period of 60 months. (TRFA Ex. H, L) In 1984 and within the 12-month period of IRC §337, XYZ distributed all of its assets to its shareholders in complete liquidation. The “Somebody”s reported a capital gain of \$2,935,539 on Schedule D of their 1984 federal Form 1040 resulting from the liquidating distribution received from XYZ. (Taxpayer Ex. No. 24) Taxpayers reported a capital gain of \$248,617 on Schedule D of their 1985 federal Form 1040 resulting from payments received by AAA on the installment note that had been distributed to the “Somebody”s in liquidation of XYZ. (Taxpayer Ex. No. 26)

CONCLUSIONS OF LAW:

I have the uncomfortable task of hearing this case and making a recommendation after the tragic deaths of the taxpayers. However, their claim was filed during their lifetimes and is properly before me and deserves a ruling on the merits, as assets of their estates are at issue.

⁴ According to Section 337 of the Internal Revenue Code, now repealed, if a corporation pursuant to a plan of complete liquidation distributed all of its assets to its shareholders within a 12-month period, the corporation would not recognize gain or loss on the sale or exchange of its property (other than nonqualifying property). The shareholders would then report gain or loss on the exchange of their stock for the property received.

At issue here is whether certain capital gains arising from the disposition of XYZ Supply Company are properly taxable by the State of Illinois. The Department has raised two alternative theories: the taxpayers were residents of Illinois during 1984 and 1985 and therefore the income from the sale of XYZ would be allocated to Illinois as the domicile of the taxpayers, and second, since the sale of the company was a sale of assets and the assets were located in Illinois, the gain would be attributed to Illinois.

Although taxpayers' attorneys have objected to the inclusion of the residency issue in this case, it is clear that taxpayers' non-residency is an essential element to taxpayers' claim. Taxpayers filed no Illinois income tax returns in 1984 and 1985. After examination by the Department and the issuance of a Notice of Deficiency, taxpayers paid the tax due on the gain from the disposition of the XYZ stock, and filed a claim for refund which is the subject matter of this case. Taxpayers are seeking a refund of taxes paid because, they argue, the capital gains were not taxable in Illinois. If taxpayers were Illinois residents, however, the gain on the sale of XYZ, as well as all of their other income, would be taxable in Illinois. Therefore, it is incumbent on the taxpayers to show that they were not Illinois residents or their claim must be denied.

According to §201 of the Illinois Income Tax Act,⁵ "A tax measured by income is hereby imposed on every individual, corporation, trust and estate...on the privilege of earning or receiving income in or as a resident of this State." The term resident is defined at §1501(a)(20):

- (A) an individual (i) who is in this State for other than a temporary or transitory purpose during the taxable year; or (ii) who is domiciled in this State but is absent from the State for a temporary or transitory purpose during the taxable year.

"Nonresident" is defined at §1501(a)(14) as "a person who is not a resident."

⁵ Unless otherwise noted, reference to sections are to the Illinois Income Tax Act, 35 ILCS 5/101 et seq.

Departmental regulations interpret who is a resident for income tax purposes. Section 100.3020(b)⁶ states:

The purpose of the general definition is to include in the category of individuals who are taxable on their entire net income, regardless of whether derived from sources within or without Illinois, all individuals who are physically present in Illinois enjoying the benefit of its government, except those individuals who are here temporarily, and to exclude from this category all individuals, who, although domiciled in Illinois, are outside Illinois for other than temporary and transitory purposes, and, hence, do not obtain the benefit of Illinois government. If an individual acquires the status of a resident by virtue of being physically present in Illinois for other than temporary or transitory purposes, he remains a resident even though temporarily absent from Illinois.

Taxpayers introduced Mr. “Somebody”’s driver’s license, his voting registration, and his affidavit claiming Florida residency to show that the “Somebody”’s had changed their domicile from Illinois to Florida. Taxpayer had a Florida drivers license since 1977, even though there has been no suggestion that he became a Florida resident in 1977. However, Mr. and Mrs. “Somebody” also held valid Illinois driver’s licenses for 1984 and 1985. Thus, I can ascribe no weight to the driver’s licenses since there is evidence going both ways.

Mr. “Somebody” registered to vote in Florida in October of 1985, at the end of the relevant period. I take administrative notice of the fact that 1984 was a presidential election year, and the fact that Mr. “Somebody” did not register to vote in Florida until the end of 1985 cuts against his intention to make Florida his residence during 1984. Finally, taxpayers’ niece testified that the “Somebody”’s residence in Florida was more than a “vacation home” in the sense that it was the equivalent of a full-size house, the kitchen was fully-stocked and Mr. “Somebody”’s personal papers and computer were kept there.

⁶ 86 Admin. Code ch. I, §100.3020(b).

The Department, on the other hand, introduced evidence which contravenes taxpayers' assertion of nonresidency. The one piece of evidence which I feel has the greatest probative value on the matter is the Petition for Dissolution of Marriage which Mr. "Somebody" filed on March 25, 1985 with the Cook County Circuit Court. Contrary to taxpayers' counsel's assertion that the fact that the dissolution was not pursued renders it irrelevant to the matter at hand,⁷ Mr. "Somebody" subjected himself to the jurisdiction of the Cook County Circuit Court, and in order to file such a petition for dissolution, Mr. "Somebody" was required to be a resident of the State of Illinois. 750 ILCS 5/401. His voluntary, sworn statement of Illinois residency, therefore, is clearly relevant and must be considered together with all other evidence submitted. The petition was signed under penalties of perjury and stated that, on March 25, 1985, Mr. "Somebody" was a resident of Cook County. This petition listed as an asset a "vacation home" that the couple owned in Somewhere, Florida.

Not only does Mr. "Somebody", subject to penalties of perjury, state that he is a resident of Cook County and that his home in Florida is merely a vacation home, but it is also evidence that Mr. "Somebody", while physically present in Illinois enjoyed the benefit of its government through its court system, clearly an indicator of residency as set forth in the above regulation.

The Department also introduced a letter from the Florida Department of Revenue which stated that the taxpayers did not file intangible tax returns in Florida in 1984 and 1985, as they would be required to do if they were Florida residents with intangible assets. Fla. Stat. §199.052

Counsel for taxpayers offered nothing to rebut either the fact that intangible tax returns were required or that taxpayers failed to file the tax returns.

⁷ By the doctrine of judicial estoppel, had the divorce proceedings concluded, taxpayer would have been barred from arguing nonresidence. See Ceres Terminals, Inc. v. Chicago City Bank and Trust,

It appears from the evidence submitted that taxpayers attempted to have it both ways: by using their abodes in two states, they escaped paying tax in either. Whether failing to file tax returns in both Illinois and Florida was intentional or due to oversight, however, is not at issue here. The issue before me is limited to determining whether taxpayers were Illinois residents during 1984 and 1985.

Taxpayers also argue that the Department should be bound by the earlier determination made in the letter of Rebecca Smith which states that the Department would not pursue the residency issue and the letter of Michael Hoff of BCI which indicates that the Department had accepted taxpayers' assertion of residency. The Department is not bound by the mistakes of its employees in the collection and administration of taxes. Austin Liquor Mart, Inc. v. Department of Revenue, 51 Ill.2d 1 (1972). Once the protest brought this matter before the Office of Administrative Hearings, the Department's litigator was entitled to develop his own theory of the case as well as setting forth a position regarding what the Department believes is a correct analysis of the law as it pertains to the facts herein.

If additional information comes to light as a result of the discovery process, the litigator is certainly able to use it. The Department cannot be bound in its determination by the documents and records the taxpayer may selectively choose to hand over during the audit. In this case, the auditors accepted Mr. "Somebody"'s affidavit in making their determination that the "Somebody"'s were residents of Florida. At best, the affidavit is self-serving, and compared with the Petition for Dissolution, which he signed under penalties of perjury in an unrelated matter at a time when there was no litigation pending with the Department, the affidavit must be given less weight.

259 Ill. App. 3d 836, 851 (1st Dist. 1994). So while judicial estoppel does not apply here, the petition is nevertheless evidence to which I may assign its relevant weight.

I find that taxpayers failed to prove by a preponderance of the evidence that they were nonresidents during 1984 and 1985, and therefore their claim for refund must be denied.⁸

It is unnecessary to reach the question of whether taxpayers' capital gains were business or non-business income in light of my finding that the "Somebody"s were Illinois residents.

WHEREFORE, for the reasons stated above, it is my recommendation that the Notice of Denial should be affirmed.

Date:

Linda K. Cliffl
Administrative Law Judge

⁸ As Illinois residents, all of their income should have been subject to Illinois taxation, not just the capital gains. However, since this is a claim for refund for taxes paid, I cannot assess additional taxes.