

General Information Letter: Estimated tax was required to be paid on the entire gain realized by the taxpayer on a sale that qualifies for the installment method of reporting, if the taxpayer elects not to use the installment method.

October 14, 2010

Dear:

This is in response to your letter dated September 14, 2010 in which you request penalty abatement in regard to your 2009 estimated tax liability. The nature of your request and the information provided requires that we respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code § 1200.120(b) and (c).

Your letter states:

It was suggested by Revenue Tax Specialist Mr. Z that I write to you for a review of the facts surrounding the 2009 Illinois Tax Return filed on April 15th by my wife and I. I have discussed the underlying issue with both Mr. Z and Ms. Y (Chicago Revenue Tax Specialist II) both have indicated that their authority limits do not allow variations from 2210 in calculating taxes or penalties due. Both have indicated that pre-payment of future taxes as encountered by election of the federal waiver for applying the Installment Method on Installment Sales (Publication 537) does not exactly fit Form 2210 which assumes the income was actually received in the tax year (2009) and is not being pre-paid for installment sale income for future years (2010) and (2012).

In my case, I turned in company stock in March 2009 and received a two year note with projected payments as follows: nine in 2009, twelve in 2010 and three in 2011. The total long term capital gains associated with the entire sale was \$1,078,509. I was actually paid 8 of the scheduled 2009 payments for a 2009 related income of \$357,341. For federal reasons, I felt it was in my best interest to Elect Out of the Installment Method (page 5 Publication 538) which I elected to do on April 14th, 2010 just prior to paying 2009 taxes. Until that point in time when the opt out election was made, I had paid sufficient Illinois estimated taxes on that basis and was owed a refund of \$749.00. When I elected to pre-pay the future 2010 and 2011 taxes (\$721,249), my tax bill increased and I paid the full amount \$20,888 on 4/15/2010 at the Chicago office of the Illinois Department of Revenue.

What I am requesting is consideration for some sort of variation or modification from standard Form 2210 where the total "2009" taxes are divided by four (line 8). If the amount of future taxes paid in 2009 were removed from line 1 (resulting in a figure of \$10,587), it would show that the proper withholding and estimated taxes were more than adequate for the actual income received in 2009 and that the payment of the extra \$20,888 was for taxes that, otherwise would have been earned in 2010 and 2011.

Please call my cell XXX-XXX-XXXX if you have any questions. I am currently recovering from a quintuple heart bypass experienced in STATE and am not receiving mail sent to the CITY1 address. I can get mail for the next 8 weeks during recovery at P.O. Box XXX, CITY2, STATE XXXXX. Can I be the only Illinois resident that ever elected out of the Installment Sale on the federal return? I have attached several pages of the federal publication 538 that explains Installment Sales and Opting Out of Installment Sales for your convenience. Opting Out can be

done with no penalty up to April 15 of the following tax year (4/15/2010) which is what I did. Please remove the Illinois' penalty.

RULING

Section 804(a) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/804(a)) imposes a penalty for underpayment of estimated tax.

In general. In case of any underpayment of estimated tax by a taxpayer, except as provided in subsection (d) or (e), the taxpayer shall be liable to a penalty in an amount determined at the rate prescribed by Section 3-3 of the Uniform Penalty and Interest Act upon the amount of the underpayment (determined under subsection (b)) for each required installment.

Section 804(b) defines "underpayment" as the amount of the "required installment" that is not paid on or before the last day prescribed for payment. The "required installment" is generally defined in Section 804(c)(1) as 25% of the required annual payment. The "required annual payment" means the lesser of:

- (i) 90% of the tax shown on the return for the taxable year, or if no return is filed, 90% of the tax for such year, or
- (ii) 100% of the tax shown on the return of the taxpayer for the preceding taxable year if a return showing a liability for tax was filed by the taxpayer for the preceding taxable year and such preceding year was a taxable year of 12 months. 35 ILCS 5/804(c)(1)(B)

IITA Section 804(c)(2) states that the required installment shall be the annualized income installment where that amount is less than 25% of the required annual payment. This provision allows taxpayers who receive their income unevenly throughout the year to align their estimated tax obligation with receipt of their income.

IITA Section 804(e) provides an exception to the penalty imposed under Section 804(a).

The penalty imposed for underpayment of estimated tax by subsection (a) of this Section shall not be imposed to the extent that the Director or his or her designate determines, pursuant to Section 3-8 of the Uniform Penalty and Interest Act that the penalty should not be imposed.

Section 3-8 of the Uniform Penalty and Interest Act ("UPIA" ; 35 ILCS 735/3-8) provides that no penalty shall be imposed if reasonable cause exists.

The penalties imposed under the provisions of Sections 3-3, 3-4, 3-5, and 3-7.5 of this Act shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department. A taxpayer may protest the imposition of a penalty under Section 3-3, 3-4, 3-5, or 3-7.5 on the basis of reasonable cause without protesting the underlying tax liability.

Department Regulations Section 700.400 (86 Ill. Adm. Code 700.400) provides rules regarding

reasonable cause. Subsection (b) of Section 700.400 states:

The determination of whether a taxpayer acted with reasonable cause shall be made on a case by case basis taking into account all pertinent facts and circumstances. The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion.

Subsection (c) of Section 700.400 states:

A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. A determination of whether a taxpayer exercised ordinary business care and prudence is dependent upon the clarity of the law or its interpretation and the taxpayer's experience, knowledge, and education. Accordingly, reliance on the advice of a professional does not necessarily establish that a taxpayer exercised ordinary business care and prudence, nor does reliance on incorrect facts such as an erroneous information return.

Subsection (f) of Section 700.400 sets forth various factors the Department considers in determining the existence of reasonable cause, including:

Could the event cited have been reasonably anticipated? Was the event one that should have been anticipated (e.g. a vacation or scheduled absence) or was it unexpected, unavoidable, or otherwise unplanned (e.g. an emergency or disaster).

Applying the above provisions to the facts stated in your letter, there is no basis for excluding certain income and associated tax from the computation of estimated tax required under IITA Section 804. Estimated tax payments must be made on the basis of the lesser of 90% of the tax shown on the return for the taxable year, or 100% of the tax shown on the return for the preceding taxable year, and must be paid in either four equal installments or determined in accordance with the annualized installment method. Therefore, the Department may not determine your estimated tax liability by modifying the Form IL-2210 as proposed in your letter.

In addition, the facts stated in your letter are not sufficient to establish reasonable cause under IITA Section 804(e) and UPIA Section 3-8. You cite your election out of the installment method of accounting under Internal Revenue Code Section 453(d) as the cause of your failure to timely pay the required amount of estimated tax. Under federal income tax law, where an election out of the installment method is made, the taxpayer must recognize the entire amount of gain in the year of sale. Treas. Reg. § 15a.453-1(d). Gain is computed using as the amount realized the fair market value of the buyer's installment obligation. Treas. Reg. § 15a.453-1(d)(2). The election must be made by the due date (including extensions) for filing the taxpayer's return for the taxable year in which the sale occurs, and is made by reporting on the return the full amount realized from the sale. Treas. Reg. 15a.453-1(d)(3).

In this case, the installment sale occurred on March 29, 2009, prior to the due date of the first installment of 2009 estimated tax. Although the election out of the installment method must be made by the extended due date of the 2009 return, the election and its tax consequences could reasonably have been anticipated on or near the date of sale in March 2009. An estimated tax penalty could have

been avoided by making payments based upon 100% of the tax shown on the return for the 2008 taxable year. Therefore, the facts stated in your letter do not support the conclusion that you exercised ordinary business care and prudence to determine and file and pay your proper tax liability.

You have indicated that you were not assessed a federal estimated tax penalty. The documentation you provided related to your federal return is not sufficient to determine the amount of your federal estimated tax obligation. The instructions for federal Form 1040, Line 76, set forth several exceptions to the estimated tax penalty, any one of which may have been applicable in your case.

You are free to challenge the Department's penalty determination. To do so, you should file a claim for refund for the amount of penalty. If your claim is denied, you have the right to protest the claim denial in an administrative hearing.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you wish to obtain a PLR which will bind the Department, please submit a request conforming to the requirements of 2 III. Adm. Code § 1200.110(b).

Sincerely,

Brian L. Stocker
Associate Counsel (Income Tax)