

Pass-through entity may not claim refund or credit for overpayment of withholding. (This is a GIL).

January 30, 2019

Re: Illinois income tax

Dear Xxxxx:

This is in response to your letter dated December 26, 2018. The nature of your request and the information you have 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 86 Ill. Adm. Code 1200.120(b) and (c), which may be accessed from the Department's web site at www.Iltax.com.

In your letter you have stated the following:

I am writing you in connection with amended partnership returns filed for our above-named client for the calendar years of 2014, 2015 and 2016. I would like to request a private letter ruling for the three years referenced above in connection with amended partnership returns filed for the referenced years. COMPANY filed amended partnership returns for 2014, 2015 and 2016 due to the fact that they received an amended K-1 from an investment in COMPANY 1 which they own. COMPANY 1 amended its partnership return to claim research credits for 2014, 2015, and 2016. The results of these amended returns are summarized as follows:

[Tabular materials omitted].

The above claimed refunds have been denied by the Department of Revenue on the theory that Line 59, Column B cannot be less than Line 59, Column A of the Form 1065X. Apparently, this limitation has been imposed as a result of the Administrative Rules contained in IITA, Section 709.5. This administrative rule is not consistent with either the instructions to Form 1065 nor the Illinois Code Section 709. Following are the instructions for Form 1065 for the relevant years:

2014 1065X Instructions. Line 59- Complete all steps of Illinois Schedule B and enter the amount from Illinois Schedule B, Step 1, Line 8 on this line. This is the amount of pass-through withholding payments you reported on behalf of your members. You must attach a corrected Illinois Schedule B if there is a change in the information reported on your most recently filed

Illinois Schedule B. You must also issue revised Schedule(s) K-1-P to your partners if any amounts reported to them on the original Schedule(s) K-1-P you issued have changed. Mark the top of the revised Schedule(s) K-1-P you issue as "Revised."

2015 1065X Instructions. Line 59 – Complete all sections of Illinois Schedule B and enter the amount from Illinois Schedule B, Section A, Line 8 on this line. This is the amount of pass-through withholding payments you owe on behalf of your members. Attach Illinois Schedule B to your Form IL-1065. See "Definitions to help you complete your Form IL-1065" in these

instructions for more information. Do not include on Line 59 any pass-through withholding payments reported to you on Schedule(s) K-1-P or K-1-T. Pass through withholding payment amounts reported to you are included on Step 9, Line 61c.

2016 1065X Instructions. Line 59 – Complete all sections of Illinois Schedule B and enter the amount from Illinois Schedule B, Section A, Line 9 on this line. This is the amount of pass-through withholding payments you owe on behalf of your members. You must attach a corrected Illinois Schedule B if there is a change in the information reported on your most recently filed Illinois Schedule B. See “Definitions to help you complete your Form IL-1065” in the Form IL-1065 instructions for more information. Do not include on Line 59 any pass-through withholding payments reported to you on Schedule(s) K-1-P or K-1-T. Pass-through withholding payment amounts reported to you are included on Step 10, Line 61c. You must also issue revised Schedule(s) K-1-P to your partners if any amounts reported to them on the original Schedule(s) K-1-P you issued have changed. Mark the top of the revised Schedule(s) K-1-P you issue as “Revised.”

The above referenced instructions for all three years make it clear that an amended partnership return should “attach a corrected Illinois Schedule B if there is a change in the information reported on your most recently filed Illinois Schedule B.” I believe that the above instructions are consistent with Section 709.5 of the Illinois Code (copy attached) and that the administrative rule under IITA Section 709.5 is not consistent with the language or intent of the Illinois law. It is also my belief that the amended returns filed for COMPANY were filed in complete compliance with the Illinois statutes and that the refund claimed should be allowed in full.

Further, it is not possible to complete Form IL1065X in a manner which complies with the Administrative Rule in a situation where taxable income changes due to the fact that income reported on Schedule B must reconcile with income reported on Form 1065X. It appears to this writer that the Administrative Rule was adopted (without reference to the Illinois Statute) for the simple reason that it is believed that taxpayers may not file amended returns as required by Illinois law to reflect reduced withholding. In this case, the flow-through of the Illinois research credit should cause non-resident withholding to decrease which will result in the individual taxpayers being allowed smaller refunds on their individual 1040X returns due to the reduced non-resident withholding reported on amended Illinois K-1-Ps. It seems to this writer that the adoption of the administrative rule under Section 709.5 is inconsistent with the requirements of the Illinois Statutes that require non-residents to file returns on Illinois income and is contrary to the proper administration of the Illinois Statutes.

I believe that these arguments support the fact that COMPANY filed its amended Illinois 1065X properly and in accordance with the Illinois Statutes and is entitled to receive the refunds for each of the years involved as outline above.

RULING

IITA Section 709.5(a) imposes an income tax withholding requirement on partnerships, S corporations, and trusts, with respect to the shares of business income, and certain nonbusiness income, of nonresident partners, shareholders, or beneficiaries. IITA Section 709.5(b) provides, in part:

Credit for taxes withheld. Any amount withheld under subsection (a) of this Section and paid to the Department shall be treated as a payment of the estimated tax liability ... of the partner, shareholder, or beneficiary to whom the income is distributable for the taxable year in which that person incurred a liability under this Act with respect to that income.

As IITA Section 709.5 indicates, once an amount withheld has been paid to the Department, the amount is treated as a payment of the estimated tax liability of the partner.

Pursuant to this provision, the Department promulgated Regulations Section 100.7035(e), which states:

Overpayments. A pass-through entity may not claim a refund or credit for any overpayment of withholding due under subsection (a) with respect to any owner. In addition, an owner has no right of action against the pass-through entity for overpayment of withholding. (See IITA Section 712.) In the case of any overpayment, the remedy is for the owner to file a timely claim for credit or refund for any amount withheld under subsection (a) with respect to it.

Because amounts withheld and paid under IITA Section 709.5 are considered payments of the partner, these amounts may not be refunded to the partnership. As Regulations Section 100.7035(e) provides, if as a result of an overpayment of pass-through withholding the individual partner has an overpayment for the taxable year, the proper remedy is for the individual partner to file a timely claim for refund.

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 have further questions regarding this GIL, please call (217) 782-7055. If you have additional questions regarding Illinois income tax laws, please visit the Department's web site at www.Iltax.com.

Sincerely,

Brian L. Stocker
(Associate Counsel – Income tax)