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# Application and Abatement of Penalties in Illinois

At the close of an audit, in addition to tax and interest, a taxpayer may also be assessed various types of penalties that can often be substantial and even surpass the underlying tax liability. However, there are several courses of action for seeking penalty abatement, which can often prove to be a worthy exercise for taxpayers. As such, when faced with an audit, taxpayers should become familiar with: (1) the potential penalties that may result from underpayment or missed filing deadlines; (2) the legal basis for relief; (3) and the process and requirements for seeking penalty abatement.

## Application of Illinois Penalties

The Illinois Department of Revenue ("Department") imposes various forms of penalties under the authority of the Uniform Penalty and Interest Act ("UPIA").[1] The UPIA applies to all taxes administered by the Department, except for the Racing Privilege Tax Act, the Property Tax Code, the Real Estate Transfer Tax, and the Coin Operated Amusement Device Tax.[2] Specifically, the Department imposes penalties ranging from the failure to file or pay, which is imposed at a rate of 2 percent of the tax due on a return (up to a maximum of $250), to more onerous penalties, including the negligence penalty.[3] The Department imposes penalties at a rate of 20 percent of the resulting deficiency for a return prepared negligently, including careless, reckless, or intentional disregard of the law, but without intent to defraud.[4]

As a result, Illinois penalties can quickly accumulate for taxpayers. For example, if a taxpayer files a return with intent to defraud, the Department imposes fraud penalties, which are not eligible for reasonable cause abatement, at a rate equal to 50 percent of the deficiency.[5] Further, if a taxpayer has a tax liability for a period that was eligible for amnesty under the Tax Delinquency Act but the taxpayer did not resolve the liability during that period, the Department has the authority to impose penalties at a rate of 200 percent of the rate that would have otherwise been imposed.[6] Accordingly, if a taxpayer incurred a liability during the tax periods covered by the most recent amnesty program, July 1, 2002 through June 30, 2009, the Department has the authority to impose penalties at a rate of 200 percent of the general rate.[7]

## Requesting Abatement of Illinois Penalties: Audit Level and on Appeal

Taxpayers may seek relief from certain penalties at the audit level, protest a Proposed Notice of Tax Liability to the Informal Conference Board ("ICB"), or appeal a final assessment to the Illinois Independent Tax Tribunal ("Tribunal"), the Circuit Court, or the Illinois Board of Appeals ("Board"). The interplay because these legal forums and the procedure for protesting a Proposed Notice of Tax Liability to the ICB or appealing a final assessment to the Tribunal and Circuit Court are addressed in detail in a prior post. Accordingly, although penalty relief can also be sought at the ICB, Tribunal, or Circuit Court, this post will focus on the process for seeking penalty relief in audit or appealing a final assessment to the Board.

### 1. GROUNDS FOR RELIEF: REASONABLE CAUSE

Regardless of whether taxpayers seek relief at the audit level, the ICB, the Tribunal, the Circuit Court or the Board, the same controlling law will generally apply. Illinois law provides that penalties for failure to file or pay, failure to file correct information returns, and negligence do not apply if a taxpayer shows that its failure to file and pay tax at the required time was due to reasonable cause.[8] The most important factor to be considered in making a determination to abate penalties is the extent to which the taxpayer made a good faith effort to determine its proper tax liability and to pay its property tax liability in a timely fashion.[9] A taxpayer will be considered to have made a good faith effort to determine and pay its proper tax liability if it exercised ordinary business care and prudence in doing so.[10] In other words, the taxpayer must have "reasonable cause" for its failure to file or pay a required tax.[11] Additionally, pursuant to the Illinois Taxpayers' Bill of Rights Act, the Department must abate all penalties assessed based upon erroneous written information or advice given to the taxpayer.[12]

Although is little guidance in Illinois case law, Illinois' regulations, administrative rulings, and federal tax cases help illustrate what constitutes "reasonable cause."[13] For example, taxpayers should focus on the legal basis for their filing position, including the statute, regulation, ruling or case law relied upon that supports the taxpayer's position.[14] The taxpayer should highlight the complexity of the law or any areas of ambiguity in the law.[15] Additionally, although the Department is not bound by its former audit determinations, it can be persuasive that the taxpayer was previously audited on the same issue only to result in a different taxing determination.[16]

**2. REQUESTING RELIEF AT AUDIT LEVEL**

The key with seeking relief at the audit level is to take the offensive. When issued the proposed audit results or prior to the closing conference, taxpayers are generally afforded the opportunity to request the abatement of penalties based on reasonable cause. Generally, it can be easier to request that penalties not be assessed than to request forgiveness once formally assessed. It is advisable to seek the request in writing, as opposed to providing the request orally, because it increases the likelihood the request is reviewed by the appropriate party and creates a paper trail for purposes of the audit file, if ultimately appealed. There is little downside to requesting penalty relief at the audit level because such requests generally do not bar subsequent review of the same penalty issue. However, the Board has recently taken the position that it does not have jurisdiction to consider penalty abatement if the ICB, which is technically considered part of audit, already denied the request.

**3. APPEAL TO THE BOARD OF APPEALS**

The Board is comprised of three members appointed by the Director of the Department who have the authority only to: (1) waive penalties or interest based on reasonable cause; and (2) reduce a tax liability because the full debt cannot collected.[17] The Board does not have the authority to review the decisions of the Tribunal, administrative hearings, or the Circuit Court. As a result, a taxpayer cannot double-dip, meaning a taxpayer cannot seek penalty abatement at the Tribunal or Circuit Court, and when denied relief, then seek abatement by the Board. Additionally, the Board only has jurisdiction once the liability is final, meaning that all Tribunal and court proceedings to review the assessment are final and the protest period for taking such action has expired.[18] As a result, although the Board cannot be utilized to redetermine or challenge the tax assessed, the Board is an appropriate forum for pursuing penalty abatement or a payment plan due to financial hardship once the liability is final.

To appeal to the Board, taxpayers must file a written Petition by completing the Form BOA-1.[19] The

taxpayer must provide the reasons for relief, which should address the grounds for reasonable cause set forth above, in addition to the taxpayer's compliance history, if persuasive to the appeal.[20] Additionally, taxpayers should request the issuance of a temporary restraining order ("TRO") to prevent the Department from pursuing collection action for the debt until a decision is made. A TRO is often vital to prevent unwanted collection action against the business and its officers, shareholders, or members while the matter is pending at the Board. Although not required, taxpayers may also request a hearing, which is an opportunity to provide additional information and explanation for relief to a hearing officer or Board member.[21] Once the hearing is complete, the Board reviews the matter and seeks additional information from Department employees. For penalty relief to be granted, at least two of the three Board members must approve the request for relief and the Director of the Department must approve the Board's recommendation.[22] Decisions of the Board are not subject to the provisions of the Administrative Review Law.[23]

Although the Board is a useful alternative to the Tribunal or Circuit Court when seeking penalty relief or a payment plan, taxpayers considering sending their case to the Board should be aware of the current backlog of cases that have resulted in delayed response times. Likely due to the Board's substantial caseload, there has understandably been a trend in the Board rejecting jurisdiction over matters, including taxpayers who previously requested penalty abatement at ICB. This creates a significant risk for taxpayers who allow an assessment to become final, because if the Board does ultimately deny jurisdiction, the appeal window to the Tribunal, administrative hearings, or the Circuit Court will have lapsed. As a result, to increase the likelihood of acceptance by the Board, taxpayers must be careful to submit a coherent request that includes all necessary information.

## Conclusion

If not in compliance with state or local taxes, taxpayers risk the application of substantial penalties. However, regardless of whether a taxpayer is slapped with a minor or exorbitant penalty, it is often worth pursuing abatement of the penalty at either the audit level or on appeal.

Please reach out to Samantha K. Breslow with any questions.

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[1] 35 ILCS §735/3-1,*et seq*.

[2] 35 ILCS §735/3-1A

[3] 35 ILCS §735/3-3.

[4] 35 ILCS §735/3-5.

[5] 35 ILCS §735/3-6.

[6] 35 ILCS §745/10; 35 ILCS §735/3-3(i); 35 ILCS §735/3-3(j).

[7] 35 ILCS 745/10.

[8] 35 ILCS §735/3-8.

[9] 86 Ill. Admin. Code §700.400(b).

[10] *Id*.

[11] *Kroger Co. v. Ill. Dep't of Rev.*, 284 Ill. App. 3d 473 (1st Dist. 1996).

[12] 20 ILCS 2520/4(c).

[13] *Ill. Dep't of Rev. v. Rarified Chemical Company*, IT 99-17 (08/01/1999).

[14] *See* 86 Ill. Admin. Code §700.400(e)(8).

[15] 86 Ill. Admin. Code §700.400(c).

[16] *See Peoria Hotel Co. v. Ill. Dep't of Rev.* 87 Ill. App. 3d 176, 178 (3d Dist. 1980); *Mr. Car Wash, Inc. v. Ill. Dep't of Rev.*, 27 Ill. App. 3d 931, 932 (4th Dist. 1975); *Austin Liquor Mart, Inc. v. Ill. Dep't of Rev.*, 18 Ill. App. 3d 894, 895 (1st Dist. 1974).

[17] 86 Ill. Admin. Code 210.120(b).

[18] 86 Ill. Admin. Code 210.120(a); 86 Ill. Admin. Code 210.101.

[19] 86 Ill. Admin. Code 210.101.

[20] 86 Ill. Admin. Code 210.120(d).

[21] 86 Ill. Admin. Code 210.105.

[22] 86 Ill. Admin. Code 210.110(a); 86 Ill. Admin. Code 210.135(a).

[23] 86 Ill. Admin. Code 210.135(b).