

IT 11-01

Tax Type: Income Tax

Issue: Gambling Winnings When Calculating Illinois Net Income

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

JOHN DOE & JANE DOE,)	Docket No.
Taxpayers)	Account No.
v.)	Tax Year
THE DEPARTMENT OF REVENUE)	John E. White,
OF THE STATE OF ILLINOIS)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: John Doe appeared, pro se, for Taxpayers; Ronald Forman, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter involves an amended return that John Doe (Doe) and Jane Doe (Taxpayers) filed with the Illinois Department of Revenue (Department) to claim a refund of tax paid to Illinois regarding tax year ending December 31, 2003. The Department responded to Taxpayers' amended return by issuing a Notice of Claim Denial (Denial). The Denial did two things: it denied the requested refund; and it notified Taxpayers that an additional amount of tax, penalties and interest was due from them regarding 2003. Taxpayers protested the Denial, and asked for a hearing.

The hearing was held at the Department's offices in Chicago. Doe appeared and testified at hearing, and he also offered into evidence documents regarding income he earned from winning Illinois lottery drawings in 2003. I am including in this recommendation findings of fact and conclusions of law. I recommend that the Director

uphold the Department's determination that no refund is due, and that he revise the Denial's notice and demand to correspond to the Department's corrections of errors contained within it.

Findings of Fact:

1. Taxpayers filed an Illinois individual income tax return for tax year ending December 31, 2003, as Illinois residents. Department Ex. 1, pp. 5-6 (copy of Taxpayers' original Illinois return, dated May 25, 2004).
2. On their original Illinois return, Taxpayers reported that their adjusted gross income (AGI) was \$38,111. Department Ex. 1, p. 5.
3. In 2008, Taxpayers filed an amended Illinois return for 2003, on which they reported that their AGI had been increased to \$46,361, based on a final federal change. Department Ex. 1, pp. 3-4 (copy of Taxpayers' amended Illinois return, dated November 11, 2008); *see also* 35 ILCS 5/506(b). Taxpayers reported that the IRS increased their AGI for 2003 to correct Taxpayers' error in omitting, from their original federal return, income realized from winning drawings authorized by the Illinois State Lottery (Lottery). Department Ex. 1, pp. 3-4.
4. Taxpayers reported the following entries on the following lines of their amended Illinois return:

Line 9	/	Other subtractions ***	\$3,250
Line 15	/	Total of all prior overpayments ***	\$ 13
Line 17	/	Illinois income tax withheld ***	\$ 943
Line 26	/	Refund [requested]	\$ 60

Department Ex. 1, pp. 3-4.

5. The \$3,250 Taxpayers reported as an “other subtraction,” was based on Doe’s receipt of income from winning Lottery drawings. Department Ex. 1, pp. 3-4; Taxpayer Ex. 1 (copy of check receipt, dated August 4, 2003, from the Lottery).
6. After reviewing Taxpayers’ amended return, the Department issued its Denial. Department Ex. 1, pp. 1-2 (copy of the Department’s Denial, dated March 20, 2009).

The first page of that Denial provided, in pertinent part:

We received your 2003 Form IL-1040-X, Amended Individual Income Tax Return, dated December 1, 2008, which you filed to amend your 2003 Form IL-1040, Individual Income Tax Return. We have completed our review. This review is not the result of an audit. We denied your claim for refund of overpayment of income tax.

We have determined that Line 9 remains \$0.00

We do not allow a subtraction for Illinois Lottery Winnings that you listed in “other subtractions.” Please refer to the Form IL-1040 Instructions for the tax year you are filing for additional information.

We changed Line 15 from \$13.00 to \$83.00.

We changed the amount of previous overpayments on Line 15 of your IL-1040-X to the amount shown in our records.

We have determined that Line 17 remains \$943.00.

We received your W-2, Wage and Tax Statement, forms. However, these forms show Illinois withholding of \$943.00. Please send us any other W-2 forms you may have showing Illinois withholding for tax year 2003.

Department Ex. 1, p. 1.

7. The second page of the Denial includes a statement titled, “Summary[:] Form IL-1040-X Financial Details” (Summary), on which the Department took into account some of the changes reported on Taxpayers’ amended return, together with the adjustments detailed on the Denial’s first page. Department Ex. 1, p. 2.

8. The Summary reflects the following Department determinations: Taxpayers' 2003 Illinois net income was \$37,250; the Illinois income tax due on Taxpayers' Illinois net income was \$1,118; Taxpayers had previously paid Illinois income tax, via withholding, in the amount of \$943, yielding an outstanding tax due of \$175; and that Taxpayers had previously received a refund of Illinois income tax for 2003 in the amount of \$83.00 which, after taking into account the revised amount of Taxpayers' Illinois net income, was not due to them. Department Ex. 1, p. 2; *see also* 35 ILCS 5/902(a); 35 ILCS 5/903(a)(3); 35 ILCS 5/905(g). The Summary further provided that a penalty in the amount of \$49.00 was due, as well as interest in the amount of \$53.21. Department Ex. 1, p. 2. At the bottom of the Denial's Summary, the Department wrote: "Amount you owe [=] 360.21. *Id.* (175 + 83 + 49 + 53.21 = 360.21).
9. Prior to and at hearing, Department counsel revised two of the determinations described within the Summary, in Taxpayers' favor. First, counsel conceded that the refund Taxpayers received for calendar year 2003 was not \$83, but was only \$13. Hearing Transcript (Tr.), pp. 6-7; Pre-Hearing Order. Counsel also conceded that Taxpayers had previously paid, via withholding, \$1,093, which was \$150 more than the withholding amount reflected on the Summary. Tr. pp. 6-7; Pre-Hearing Order.
10. After taking into account the revisions conceded by the Department, the amount of tax remaining due on Taxpayers' 2003 Illinois net income is \$38 ($1,118 - 1,093 = 25 + 13$ (erroneous refund) = 38), exclusive of penalties and interest to be imposed on that unpaid amount. *Compare* Department Ex. 1, p. 2 *with* Tr. pp. 6-7 *and* Pre-Hearing Order.

Conclusions of Law:

Section 909 of the Illinois Income Tax Act (IITA) authorizes the payment of refunds to a taxpayer that has overpaid its Illinois income tax liabilities. 35 ILCS 5/909. When a taxpayer seeks to take advantage of deductions, credits or other tax benefits allowed by statute, the burden of proof is on the taxpayer. Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296, 421 N.E.2d 236, 238 (1st Dist. 1981). That is because a deduction is a privilege created by statute as a matter of legislative grace. Bodine Electric Co. v. Allphin, 81 Ill. 2d 502, 512-13, 410 N.E.2d 828, 833 (1980). A taxpayer is not entitled to a deduction unless clearly allowed by statute and the burden is on the taxpayer to show he is entitled to the deduction claimed. *Id.* at 513, 410 N.E.2d at 833. Here, Taxpayers claimed a refund of tax previously paid over to the Department, based on, among other things, a deduction claimed for their receipt of income from playing the Lottery. Department Ex. 1, pp. 3-4; Taxpayer Ex. 1. Since Taxpayers' amended return seeks a refund that is based on their claimed deduction, Taxpayers have the burden of proof here. Bodine Electric Co., 81 Ill. 2d at 512-13, 410 N.E.2d at 833; Balla, 96 Ill. App. 3d at 296, 421 N.E.2d at 238.

The Department denied Taxpayers' refund claim after making certain determinations regarding the entries on their amended return. Department Ex. 1, p. 1. In addition to notifying Taxpayers that their refund would not be granted, the Denial also included a Summary, which informed Taxpayers of the amount of additional Illinois income tax, penalties and interest the Department determined they owed regarding 2003. Department Ex. 1, p. 2.

To support their claim that certain Lottery winnings should be deducted when calculating their Illinois net income, Taxpayers offered a copy of a receipt from the Lottery, which Doe received, with a check, after he won a Lottery drawing in 2003. Taxpayer Ex. 1. The copy of the receipt also includes Doe's handwriting, and Taxpayers tendered that receipt to the Department regarding their amended return for 2003. *Id.* The handwriting on the receipt conveys Doe's understanding that Lottery winnings are not intended to be subject to Illinois income tax if they are in an amount that is less than the amount on which either federal or state taxes would be withheld. *Id.* Taxpayers also offered into evidence other documents Doe received from the Lottery. Taxpayer Ex. 2. Taxpayer Exhibit 2 consists of a copy of the front and back of another receipt Doe received from a Lottery ticket agent, in 2010, along with a Lottery form titled, "Instructions to Winner." Taxpayer Ex. 2; Tr. pp. 16-17, 19-22 (Doe). Taxpayers offered that exhibit to corroborate Doe's testimony that Lottery agents advised him that Lottery winnings, in amounts that are below the threshold level at which tax is withheld, are not subject to tax. Tr. pp. 16-17, 19-22 (Doe).

Within the Denial, and at hearing, the Department asserted that Taxpayers may not deduct Lottery winnings from their AGI here, or when calculating Illinois net income, because the Illinois General Assembly has not authorized such a deduction. Department Ex. 1.1; Tr. pp. 7-9 (*citing* 35 ILCS 5/203(a)(2)); *see also* 35 ILCS 5/203(h).

The issue is whether Lottery winnings, in any amount, may be deducted when calculating Illinois net income. To resolve that issue, it is helpful to first summarize the law and procedures for calculating an individual's Illinois income tax liability.

The IITA imposes "a tax measured by net income ... on every individual, corporation, trust and estate for each taxable year ending

after July 31, 1969 on the privilege of earning or receiving income in or as a resident of [Illinois]." 35 ILCS 5/201(a). Section 202 defines "net income," generally, as "that portion of his base income for such year which is allocable to this State under the provisions of Article 3, less the standard exemption allowed by Section 204 and the deduction allowed by Section 207." 35 ILCS 5/202.

Section 203 of the IITA defines base income, which, for individuals, means:

(1) *** an amount equal to the taxpayer's adjusted gross income for the taxable year as modified by paragraph (2).

(2) Modifications. The adjusted gross income referred to in paragraph (1) shall be modified by adding thereto the sum of the following amounts:

and by deducting from the total so obtained the sum of the following amounts:

35 ILCS 5/203(a). Thus, the first part of § 203(a)(2) includes modifications that add amounts to an individual's AGI, and the second part includes modifications that subtract other amounts from the sum of the individual's AGI plus the addition modifications. 35 ILCS 5/203(a)(2). Other than the modifications expressly detailed within IITA § 203, § 203(h) prohibits any attempt to limit or modify items of income, loss or deduction that are taken into account when determining an individual's AGI, or any attempt to limit or modify such items when calculating the person's Illinois base or net income. 35 ILCS 5/203(h).

Section 203(e) defines "adjusted gross income" to mean "the amount of ... adjusted gross income properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code [the Code]." 35 ILCS 5/203(e)(1). The intent underlying § 203(e) is to provide a fixed and easily ascertainable

starting point for taxpayers – as well as for the Department – when determining a person’s correct Illinois income tax liability. Bodine Electric Co. v. Allphin, 81 Ill. 2d 502, 510, 512, 410 N.E.2d 828, 832-33 (1980); Hollinger International, Inc. v. Bower, 363 Ill. App. 3d 313, 316, 841 N.E.2d 447, 451 (1st Dist. 2005). This intent is made clearer when § 203 is read together with § 403, which requires taxpayers to report items of income, deduction and exclusion on an Illinois income tax return “in the same manner and amounts as reflected in [his] federal income tax return for the same taxable year.” 35 ILCS 5/403(a); Bodine Electric Co., 81 Ill. 2d at 506, 410 N.E.2d at 830.

Under federal law, income derived from gambling winnings is includable in gross income under § 61 of the Code, and must be reported on a taxpayer’s federal return. 26 U.S.C. § 61; McClanahan v. United States, 292 F.2d 630, 631 (5th Cir. 1965). Taxpayers learned this after the IRS adjusted their original 2003 federal return, to increase their AGI, based on Doe’s Lottery winnings. *See* Department Ex. 1, pp. 3-4; 35 ILCS 5/203(e)(1). Further, the Department is correct that the Illinois General Assembly has not included within § 203(a)(2) a deduction for any gambling winnings, including winnings from Lottery drawings, when calculating Illinois base or net income. 35 ILCS 5/203(a)(2). Since Doe’s Lottery winnings were included within Taxpayers’ AGI, and since Lottery winnings (or any gambling winnings) are not the subject of an Illinois deduction authorized by § 203(a)(2), Taxpayers may not deduct such winnings when calculating their Illinois base and net income. 35 ILCS 5/203(a)(2), (h).

Finally, the Lottery’s Instructions to Winner form, which Taxpayers admitted as part of their Exhibit 2, does not demonstrate that the Lottery advises those playing games that winnings are not subject to Illinois income tax. Instead, on those instructions, the

Lottery informs persons to: “*** Generally, report all gambling winnings on the “Other income” line of Form 1040. ***” Taxpayer Ex. 2. That document simply Does not support Taxpayers’ claim that the Lottery, itself, has notified anyone that Lottery winnings — in any amount — are not subject to Illinois income tax.

Conclusion:

I recommend that the Director finalize the Denial’s determination that Taxpayers are not entitled to deduct Lottery winnings when calculating their Illinois net income. Taxpayers, therefore, are not entitled to the refund requested on their amended return. Also, and as a result of the Department’s concession that two of the three determinations described within the Summary issued to Taxpayers were not correct (Tr. pp. 6-7; Pre-hearing Order), I recommend that the Director revise the Department’s records to reflect that the total amount of Illinois income tax remaining due from Taxpayers for 2003 is \$38, plus statutory interest and penalties.

April 13, 2011

John E. White
Administrative Law Judge