

General Information Letter: Illinois law does not provide for modification of the taxpayer's basis in property on which federal bonus depreciation was claimed. Subtraction modifications related to federal bonus depreciation must be computed and reported on the Schedule 4562.

April 13, 2009

Dear:

This is in response to your letter dated January 5, 2009 in which you request abatement of an estimated tax penalty and correction of changes made to the above-named taxpayer's return for its tax year ending February 2, 2008. The nature of your letter and the information provided require 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.

Your letter states as follows:

In response to the notice dated November 6, 2008, I am requesting an abatement of the assessed late estimated payment penalty and a correction to the changes made to the year ending February 2, 2008 tax return. According to the notice, the changes were a reduction in the items claimed on the Schedule M and a reduction to the amount of total payments and credits for the reporting period. However, both adjustments originated from the same source. The "State Gain/Loss Adjustment" on Line 16 of Schedule M was disallowed on the year ending February 3, 2007 and February 2, 2008 tax returns. As a result, the overpayment credited to 2007 and 2008 were reduced.

The state gain/loss adjustment represents the difference between the federal and state gain/loss calculated on bonus depreciation eligible tangible personal property disposals. ILCS Chapter 35 §5/203 (b)(2)(U) states the following:

"If the taxpayer sells, transfers, abandons, or otherwise disposes of property for which the taxpayer was required in any taxable year to make an addition modification under subparagraph (E-10), then an amount equal to that addition modification.

If the taxpayer continues to own property through the last day of the last tax year for which the taxpayer may claim a depreciation deduction for federal income tax purposes and for which the taxpayer was required in any taxable year to make an addition modification under subparagraph (E-10), then an amount equal to that addition modification.

The taxpayer is allowed to take the deduction under this subparagraph only once with respect to any one piece of property."

The aforementioned subparagraph E-10 requires the taxpayer to reflect the federal bonus depreciation deduction taken on the federal income tax return as an addition modification on the Illinois state tax return. Addition and/or subtraction modifications have been made on the Illinois state return every year that the federal bonus deduction has been taken on the federal tax return. The Illinois law addresses the treatment of the federal-state differences on the gain/loss disposal of these assets. However, it does not specify where the modification should be reported on the Illinois income tax return. As a result, a modification was reported on Line

16 of Schedule M in the amount of \$656,122 and \$641,304 to reflect the differences between the gain/loss on disposal for the year ending February 3, 2007 and February 2, 2008, respectively. We respectfully request a review of this information and an adjustment to your records.

In regard to the late estimated payment penalty, we meet one of the exceptions of the underpayment penalty computation which calculates the tax on annualized income. Please review the revised Form IL-2220, Computation of Penalties for Business, for the year ending February 2, 2008, and update your records accordingly. Based on our calculations, we request the assessed \$31,131.20 late estimated payment penalty be applied towards our year ending January 31, 2009 tax return.

RULING

In the case of a sale or other disposition of property with respect to which federal bonus depreciation deductions have been claimed, the Illinois Income Tax Act ("IITA" ; 35 ILLS 5/101 *et seq.*) requires that both an addition and subtraction modification be made to federal taxable income. First, IITA Section 203(b)(2)(E-11) requires that the taxpayer make an addition modification equal to the aggregate amount of subtraction modifications taken in all taxable years with respect to the property under IITA Section 203(b)(2)(T). Second, IITA Section 203(B)(2)(U) allows a subtraction modification equal to the addition modification under IITA Section 203(b)(2)(E-10) previously claimed with respect to the property for the bonus depreciation. These two modifications reverse all the modifications made on the property prior to disposition, so that the amount of gain or loss recognized for federal income tax purposes on disposition reflects the correct gain or loss for Illinois purposes.

The addition modification under Section 203(b)(2)(E-11), and subtraction modification under Section 203(b)(2)(U), are reported on Form IL-4562. See Form IL-4562 and Instructions. The difference between the federal gain/loss and Illinois gain/loss is not a subtraction modification to be reported on Illinois Schedule M.

IITA Section 1501(a)(12) defines the term "mathematical error" as follows:

The term "mathematical error" includes the following types of errors, omissions, or defects in a return filed by a taxpayer which prevents acceptance of the return as filed for processing:

(A) arithmetic errors or incorrect computations on the return or supporting schedules;

(B) entries on the wrong lines;

(C) omission of required supporting forms or schedules or the omission of the information in whole or in part called for thereon; and

(D) an attempt to claim, exclude, deduct, or improperly report, in a manner directly contrary to the provisions of the Act and regulations thereunder any item of income, exemption, deduction, or credit.

IITA Section 903(a)(1) states in part regarding assessment:

The amount of tax which is shown to be due on the return shall be deemed assessed on the date of filing of the return (including any amended returns showing an increase of tax). In the event that the amount of tax is understated on the taxpayer's return due to a mathematical error, the Department shall notify the taxpayer that the amount of tax in excess of that shown on the return is due and has been assessed. Such notice of additional tax due shall be issued no later than 3 years after the date the return was filed. Such notice of additional tax due shall not be considered a notice of deficiency nor shall the taxpayer have any right of protest.

COMPANY, Inc.'s failure to properly report on Form IL-4562 the addition and subtraction modifications with respect to sales of its bonus depreciation property constitutes a mathematical error under IITA Section 1501(a)(12). As a result, additional tax is deemed assessed under IITA Section 903(a)(1).

Department Regulations § 100.9200(a)(2)(C) states forth the manner in which a taxpayer should respond to a mathematical error notice of additional tax due:

The proper response to a mathematical error notice of additional tax due is for the taxpayer promptly, within the time specified in the notice (to avoid other collection efforts and the assessment of interest thereon under IITA Section 1003), to pay the amount due unless the defect(s) can be corrected by the taxpayer's furnishing correcting information including, for example, any supporting forms or schedules indicated to have been omitted from the return. If the Department timely receives payment or correcting information which satisfactorily corrects all of the defects indicated, it shall cancel the previously issued notice of additional tax due; if the information only partially corrects the defects indicated in the notice, an appropriately amended notice may be issued.

In this case, you should respond to the Department's notice by completing the Form IL-4562 to report the required modifications related to the disposition of COMPANY Inc.'s bonus depreciation property. Also, you should file a corrected Schedule M removing the transactions from that schedule. Please respond using the address and phone number provided on the Department's notice (copy enclosed). You may include a copy of this letter.

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 website at www.Iltax.com.

Sincerely,

Brian L. Stocker