

IT 11-02

Tax type: Income Tax
Issue: Net Operating Loss (General)
Statute of Limitations Application

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

THE DEPARTMENT OF REVENUE)	Docket No.
OF THE STATE OF ILLINOIS)	Tax Year
v.)	
ABC Business,)	John E. White,
Taxpayer)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Kathleen Lach and Robert Ury, Arnstein & Lehr, LLP, appeared for ABC Business; Ralph Bassett, Jr., Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis: This matter arose after ABC Business (ABC Business or Taxpayer) protested a Notice of Deficiency (NOD) the Illinois Department of Revenue (Department) issued to it regarding the tax year ending (TYE) on February 28, 2007. The NOD proposed to assess tax and interest based on the Department's determination that Taxpayer was not entitled to the entire amount of the Illinois net loss deduction (INLD) that Taxpayer reported on the Illinois return filed regarding that tax year.

The parties agreed that two of the issues in dispute included whether the Department's NOD was barred by the statute of limitations set forth in § 905(n) of the Illinois Income Tax Act (IITA), 35 ILCS 5/905(n), and if not, whether Taxpayer had an INLD available to use on its Illinois return for TYE February 28, 2007 (2/07), in excess of the INLD the Department determined was available. After considering the evidence

admitted at hearing, I am including in this recommendation findings of fact and conclusions of law. I recommend that the NOD be finalized as issued, with interest to accrue, pursuant to statute.

Findings of Fact:

1. On the federal income tax return Taxpayer filed for TYE 2/89, Taxpayer reported having federal taxable income (before net operating loss deduction) in the amount of — \$5,124,439, meaning that its federal taxable income was a net loss. Taxpayer Exhibit 2.1 (copies of Taxpayer’s original federal and Illinois income tax returns for TYE 2/89), p. 1 (line 28 of Taxpayer’s federal return).¹ On the Illinois income tax return Taxpayer filed for TYE 2/89, Taxpayer started computing its Illinois income tax liability by reporting its federal net loss in the amount of \$5,124,439. Taxpayer Exhibit 2.1, p. 54 (Part I, line 1 of Taxpayer’s Illinois form IL-1120 for TYE 2/89).
2. Of the \$5,124,439 federal net loss Taxpayer reported on its federal and Illinois returns for TYE 2/89, \$2,276,638 was the amount Taxpayer reported on its federal return as being a net loss from federal form 4797, and authorized by § 1231 of the Internal Revenue Code (IRC or the Code). Taxpayer Ex. 2.1, pp. 1 (line 9 of Taxpayer’s federal return), 13 (copy of first page of Taxpayer’s federal form 4797, Sales of

¹ Taxpayer Exhibit 2 consists of a copy of the Motion for Summary Judgment Taxpayer filed prior to hearing, and which was denied. Taxpayer Ex. 2 consists of the Motion itself, a memorandum of law, and seven exhibits. In this recommendation, I shall refer to the exhibits that make up Taxpayer Exhibit 2 as follows: Taxpayer Ex. 2A consists of a copy of the Amended Affidavit of Bruce John Doe; Taxpayer Ex. 2.1 consists of copies of Taxpayer’s federal and Illinois income tax returns for TYE 2/89; Taxpayer Ex. 2.2 consists of copies of Taxpayer’s federal and Illinois income tax returns for TYE 2/96; Taxpayer Ex. 2.3 consists of copies of Taxpayer’s federal and Illinois income tax returns for TYE 2/02; Taxpayer Ex. 2.4 consists of copies of Taxpayer’s federal and Illinois income tax returns for TYE 2/03; Taxpayer Ex. 2B consists of a copy of Taxpayer’s protest to the NOD; Taxpayer Ex. 2C consists of a copy of a Department computer screen shot of Taxpayer’s account with the Department for the period from March 1, 2002 through February 28, 2003.

Business Property, for TYE 2/89). On the form 4797 Taxpayer attached to its federal return for TYE 2/89, and on an accompanying statement, Taxpayer explained that the § 1231 property loss reported on form 4797 were attributable to its abandonment and write off of certain leasehold property. Taxpayer Ex. 2.1, pp. 1, 13, 31 (copy of Statement 18 to Taxpayer's federal return for TYE 2/89).

3. The property giving rise to the § 1231 property loss Taxpayer reported for TYE 2/89 consisted of commercial leasehold improvements it owned regarding property situated in Illinois. Taxpayer Ex. 4 (copies of, respectively: Lease, dated February 29, 1980 (1980 Lease); Assignment of Lease and Agreement, dated November 10, 1987 (1987 Assignment); and Agreement, dated November 1, 1995 (1995 Agreement)).
4. On the federal income tax return Taxpayer filed for TYE 2/96, Taxpayer reported having a federal net loss in the amount of \$1,661,193. Taxpayer Ex. 2.2 (copy of Taxpayer's federal return for TYE 2/96), p. 1 (line 28 of Taxpayer's federal form 1120). On the Illinois income tax return Taxpayer filed for TYE 2/96, Taxpayer started computing its Illinois income tax liability by reporting its federal net loss in the amount of \$1,661,193. Taxpayer Ex. 2.2, pp. 9-10 (Part I, line 7, and Part IV, line 1 of Taxpayer's Illinois form IL-1120).
5. Taxpayer did not report, on line 9 of its federal return for TYE 2/96, any loss from federal form 4797, and attributable to a § 1231 property loss. Taxpayer Ex. 2.2, p. 1.
6. Sometime during its 2002 fiscal year, which ended on February 28, 2003, Taxpayer determined that the \$2,276,638 § 1231 property loss it had previously reported on its federal return for TYE 2/89, should have instead been written off and reported on its federal return for TYE 2/96. Taxpayer Ex. 2A, ¶ 8; Taxpayer Ex. 2B, pp. 4-6.

7. After making that determination sometime during TYE 2/03, Taxpayer did not file an amended Illinois return for TYE 2/89, to notify the Department that it was decreasing the amount of its federal net loss for that year, and that such decrease would thereby affect the amount of the Illinois net loss it had previously reported on its Illinois return for TYE 2/89. Taxpayer Ex. 2A, ¶ 8; Taxpayer Ex. 2B, pp. 4-6; *see also* Taxpayer Ex. 2.1, pp. 1, 54.
8. Nor did Taxpayer file an amended Illinois return for TYE 2/96, to notify the Department that it was increasing the amount of its federal net loss for that year, and that such increase would thereby affect the amount of the Illinois net loss it had previously reported on its Illinois return for TYE 2/96. Taxpayer Ex. 2A, ¶ 8; Taxpayer Ex. 2B, pp. 4-6; *see also* Taxpayer Ex. 2.2, pp. 1, 9-10.
9. Finally, there is no evidence that Taxpayer notified the IRS that it wanted to switch the tax year during which it incurred the § 1231 property loss it reported on its federal return for TYE 2/89. *See* Taxpayer Exs., *passim*.
10. Rather than filing Illinois amended returns for its TYE 2/89 and for its TYE 2/96, Taxpayer instead performed the following acts for the following reasons:

Since it was not until 1995 (fiscal year ended February 28, 1996) when ... utilization of the leasehold improvements terminated and the loss on abandonment was realized, on Taxpayer's 2002 tax return (FY 2/03) an adjustment was made to the NLD carryforward on the Schedule NLD correcting the reporting of the abandonment loss of \$2,276,638 from its fiscal year ended 2/89 to its fiscal year ended 2/96, which was the fiscal year abandonment loss actually occurred. After the correction, the NLD for Taxpayer's fiscal year ended 2/89 was \$2,847,809 and the NLD for Taxpayer's fiscal year ended 2/96 was \$3,937,831.

Taxpayer Ex. 2B, p. 6; *see also* Taxpayer 2A, ¶¶ 8-10.

11. Notwithstanding Taxpayer's description of what it did and why, on the Schedule NLD Taxpayer completed and attached to the Illinois return it filed for TYE 2/03, Taxpayer reported \$2,847,809 as being the amount of the Illinois net loss it had previously reported on its Illinois return for 2/90 [*sic*], and it reported \$3,937,831 as being the amount of the Illinois net loss it had previously reported on its Illinois return for 2/97 [*sic*]. *Compare* Taxpayer Ex. 2.4, pp. 14-15 (copy of the completed Schedule NLD Taxpayer attached to its Illinois return for TYE 2/03) *and* Taxpayer Ex. 2.1, pp. 1, 54 *with* Taxpayer Ex. 2.2, pp. 1, 9-10. In other words, on the Schedule NLD it attached to its Illinois return for TYE 2/03, Taxpayer erred when identifying the tax years for which it was trying to notify the Department that its Illinois net losses were different than the amounts previously reported on its original Illinois returns for TYE 2/89 and 2/96.
12. On the Illinois return Taxpayer filed for TYE 2/03, Taxpayer reported having federal taxable income, and Illinois base income, in the amount of \$161,745. Taxpayer Ex. 2.4, p. 12 (Part I, line 7 of Taxpayer's Illinois return for TYE 2/03). Thus, the Illinois return Taxpayer filed for TYE 2/03 was not a return on which Taxpayer reported a net loss. *Id.*; *see also* 35 ILCS 5/905(n); 86 Ill. Admin. Code § 100.2300(b)(1)-(2) (regulation defining the terms "Illinois net loss" and "Illinois net loss deduction," respectively).
13. On the Illinois return Taxpayer filed for TYE 2/03, Taxpayer reported that its Illinois net income was zero, after claiming an INLD in the same amount as its base income allocable to Illinois. Taxpayer Ex. 2.4, p. 13 (Part IV).
14. On the Illinois return Taxpayer filed for TYE 2/07, Taxpayer reported having Illinois

base income of \$3,702,413, from which it claimed an INLD in the same amount.

Department Ex. 2 (copy of Taxpayer's Illinois return filed for TYE 2/07), pp. 1-2.

15. After reviewing Taxpayer's Illinois return for TYE 2/07, the Department issued an NOD to Taxpayer. Department Ex. 1 (copy of NOD). Taxpayer protested that NOD, and asked for a hearing. Taxpayer Ex. 2B.
16. The NOD notified Taxpayer that the Department was proposing to assess Illinois income and replacement income tax against it, after determining that the INLD reported on Taxpayer's Illinois return for TYE 2/07 should be decreased from \$3,702,413 to \$1,471,129, to coincide with the Department's account of the total of Taxpayer's previously reported Illinois net losses that would be available to use as a deduction against its Illinois base income for that tax year. Department Ex. 1, pp. 2-3; Department Ex. 6. Based on that decrease, the Department determined that Taxpayer had a net income of \$2,231,284, with a resulting tax due of \$162,884, plus interest. Department Ex. 1, pp. 1-2.
17. Prior to hearing, Taxpayer filed a Motion for Summary Judgment (MSJ), which was premised on its claim that the statute of limitations set forth in IITA § 905(n) barred the Department from finalizing the deficiency proposed in the NOD. Taxpayer Ex. 2. Taxpayer's MSJ was denied. Order Regarding Taxpayer's Motion For Summary Judgment (Order Denying MSJ).
18. Following the denial of Taxpayer's MSJ, and in response to the Department's request for discovery from Taxpayer, Taxpayer had its accountant, John Doe (John Doe), prepare schedules to demonstrate the effect that Taxpayer asserts would be made to the Illinois net losses Taxpayer reported on its original Illinois returns for TYE 2/89

and 2/96, if it had incurred the Code § 1231 loss during TYE 2/96 instead of during TYE 2/89. Taxpayer Ex. 6, pp. 1-4 (copies of schedules prepared by John Doe); Hearing Transcript (Tr.), pp. 19-26, 28-33 (John Doe).

19. John Doe also made hand-written adjustments to certain amounts reported on copies of Taxpayer's original federal forms 1120 for TYE 2/07, 2/89, and 2/96, and to its original Illinois form 1120 and Schedule NLD for TYE 2/07, and submitted those adjusted forms to the Department. Taxpayer Ex. 6, pp. 8-12.
20. Taxpayer did not intend the adjusted forms that John Doe prepared, and which Taxpayer submitted to the Department, to be considered amended federal or Illinois returns. Tr. p. 34 (colloquy upon offer of Taxpayer Exhibit 6). Rather, it prepared and tendered them to the Department, and offered them into evidence at hearing, to demonstrate its contentions regarding the effect that amending its original federal and Illinois returns for TYE 2/89 and 2/96 would have on the amount of the INLD that was available to use on Taxpayer's Illinois return for TYE 2/07. Tr. pp. 30-33 (John Doe), 34.
21. On one of the schedules John Doe prepared and Taxpayer offered into evidence, Taxpayer represented that the leasehold improvement was "abandoned in error — [TYE] 2/89." Taxpayer Ex. 6, p. 1.
22. John Doe also reduced the amount of the federal § 1231 property loss deduction Taxpayer previously reported having incurred during TYE 2/89 (Taxpayer Ex. 2.1), and which it now claims should have been reported as having been incurred during TYE 2/96, based on the reduced value of the leasehold interest over the intervening years. Taxpayer Ex. 6, pp. 1, 3, 7.

Conclusions of Law:

The Department offered the NOD into evidence under the Director's certificate of records. Department Ex. 1. Under § 904 of the IITA, that NOD is "prima facie correct and shall be prima facie evidence of the correctness of the amount of tax and penalties due." 35 ILCS 5/904(a)-(b); Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296-97, 421 N.E.2d 236, 238-39 (1st Dist. 1981). The Department's prima facie case is a rebuttable presumption. *See* Branson v. Department of Revenue, 168 Ill. 2d 247, 260, 659 N.E.2d 961, 968 (1995). A taxpayer bears the burden to rebut the presumptive correctness of the Department's determinations. PPG Industries, Inc. v. Department of Revenue, 328 Ill. App. 3d 16, 33, 765 N.E.2d 34, 48 (1st Dist. 2002); Balla, 96 Ill. App. 3d at 296-97, 421 N.E.2d at 238-39.

Issue and Arguments

The parties agree on two issues: whether the NOD is barred by the statute of limitations set forth in § 905(n); and, if not, whether Taxpayer has an INLD, in excess of the deduction allowed by the Department, that is available to be carried over and applied against the Illinois base income Taxpayer reported on its Illinois return for TYE 2/07.

Issue 1: Is the NOD Barred by IITA § 905(n)?

The first issue was the subject of Taxpayer's MSJ, which was denied. This recommendation incorporates the factual bases and full rationale for that denial, which are summarized in the following paragraphs.

On its original federal return for TYE 2/89, Taxpayer reported that it had incurred a property loss during that taxable year, as a result of abandoning and writing-off a

certain leasehold interest, and for which it claimed a deduction authorized by § 1231 of the Code. Taxpayer Ex. 2.1, pp. 1, 13, 54. Taxpayer took that federal loss deduction into account when determining the amount of its federal net loss for that year. *Id.*, p. 1. Taxpayer reported its federal net loss as the starting point when calculating its Illinois base income and Illinois net income/loss for that year. *Id.*, p. 54; 35 ILCS 5/203(b); Bodine Electric Co. v. Allphin, 81 Ill. 2d 502, 505-06, 410 N.E.2d 828, 830 (1980) (referring to IITA §§ 201-203, and 403, the Court wrote, “[t]he combined operation of these provisions serves to establish Federal taxable income as the starting point upon which State tax liability is computed.”). During Taxpayer’s fiscal year 2002, which ended in TYE 2/03, Taxpayer determined that the § 1231 property loss it previously reported having incurred on its federal return for TYE 2/89, should have been reported as having been incurred during its TYE 2/96. Taxpayer Ex. 2A, ¶ 8. On its original federal return for TYE 2/96, Taxpayer did not report that it incurred a § 1231 loss that was attributable to its abandonment and write-off of a leasehold interest. *See* Taxpayer Ex. 2.2, p. 1. So, after Taxpayer discovered what it considered a prior reporting error, Taxpayer intended to notify the Department that it was making a change to the amounts of the federal net losses that it previously reported on the original Illinois returns it filed for TYE 2/89 and 2/96. Taxpayer Ex. 2A, ¶¶ 8-9.

Section 506(b) provides that “a taxpayer shall notify the Department if ... the taxable income, any item of income or deduction, the income tax liability, or any tax credit reported in a federal income tax return of that person for any year is altered by amendment of such return or as a result of any other recomputation or redetermination of federal taxable income or loss, and such alteration reflects a change or settlement with

respect to any item or items, affecting the computation of such person's net income, net loss, or of any credit provided by Article 2 of [the IITA] for any year under this Act, or the number of personal exemptions allowable to such person” 35 ILCS 5/506(b). Such a notification “shall be made in the form of an amended return ... and shall be filed not more than 120 days after such alteration has been agreed to or finally determined for federal income tax purposes” *Id.*

Once Taxpayer determined that it had made a mistake of fact or law when reporting the amount of its federal net loss on its original Illinois return for TYE 2/89, the clear text of § 506(b) required Taxpayer to file a form IL-1120-X to notify the Department of its alteration or recomputation, since altering or recomputing the amount of its previously reported federal net loss would necessarily affect the computation of its Illinois net income or loss. 35 ILCS 5/203(b), (e); 35 ILCS 5/506(b)(1); Taxpayer Exs. 2.1-2.2, 6. And since Taxpayer intended to report that it incurred its leasehold loss during TYE 2/96 (Taxpayer Exs. 2A-2B), § 506(b) required it to file a form IL-1120-X for that year, too, to notify the Department that it was increasing the amount of the federal net loss it previously reported on its Illinois return for that tax year. Taxpayer Ex. 2.2; 35 ILCS 5/506(b)(1). Taxpayer concedes it did not file an amended Illinois return for either tax year. *See* Taxpayer Ex. 2B. Section 905(d) of the IITA expressly provides that there is no statute of limitations for the Department to issue an NOD where a taxpayer has failed to file an amended return as required by § 506(b). 35 ILCS 5/905(d).

Section 905(n) provides for two different statutory periods within which the Department must notify a taxpayer that it intends to decrease the amount of an Illinois net loss the taxpayer has reported for any taxable year ending prior to December 31, 2002.

35 ILCS 5/905(n). The first period requires the Department to notify a taxpayer of a decrease in the amount of the net loss within 3 years after the return reporting the loss was filed. *Id.* The second period requires the Department to notify a taxpayer within one year from the date an amended return was filed which modifies an Illinois net loss. *Id.* But the NOD at issue here did not decrease the amount of the Illinois net losses Taxpayer reported on either of the original Illinois returns it filed for TYE 2/89 or 2/96. *Compare* Department Ex. 1 *with* Taxpayer Ex. 2.1-2.2. Rather, it is Taxpayer who wants to reduce the amount of the Illinois net loss it reported on its original Illinois return for TYE 2/89, and who wants to increase the amount of the Illinois net loss it reported on its original Illinois return for TYE 2/96. *See* Taxpayer Ex. 2A, ¶¶ 8-9; Taxpayer Ex. 6, pp. 6-7. Since the NOD did not, in fact, decrease the amount of a net loss Taxpayer reported on any return — either an original or an amended return — § 905(n) does not even apply to the situation that occurred here. In sum, this is a § 905(d) case; it is not a § 905(n) case. I recommend, again, that the Director conclude that the NOD is not barred by the statute of limitations set forth in § 905(n).

Issue 2: Is Taxpayer Able to Claim an INLD in Excess of the Amount the Department Determined Was Available to Use for TYE 2/07?

Section 905(d) provides:

Sec. 905. Limitations on Notices of Deficiency.

(d) Failure to report federal change. If a taxpayer fails to notify the Department in any case where notification is required by Section 304(c) or 506(b), or fails to report a change or correction which is treated in the same manner as if it were a deficiency for federal income tax purposes, a notice of deficiency may be issued (i) at any time or (ii) on or after August 13, 1999, at any time for the taxable year for which the notification is required or for any taxable year to which the taxpayer may carry an Article 2 credit, or a Section 207 loss, earned, incurred, or used in the year for which the notification is

required; provided, however, that the amount of any proposed assessment set forth in the notice shall be limited to the amount of any deficiency resulting under this Act from the recomputation of the taxpayer's net income, Article 2 credits, or Section 207 loss earned, incurred, or used in the taxable year for which the notification is required after giving effect to the item or items required to be reported.

35 ILCS 5/905(d).

Section 905(d)(ii) reflects that, while there is no time limitation on the Department's authority to issue an NOD where the taxpayer has failed to file an amended return required by § 506(b), there is a limitation on the amount of the proposed deficiency. 35 ILCS 5/905(d)(ii). The limitation can be determined only after the Department "giv[es] effect to the item or items required to be reported ..." but which were not reported because the taxpayer did not file the Illinois amended return. *Id.* In other words, § 905(d)(ii) clearly reflects a legislative intent that, where there has been a final federal change to an item of federal income, deduction, etc., that affects a taxpayer's Illinois income tax liability for the same year, the Department shall determine the correct amount of tax due, if any, even though a taxpayer has failed to file the required Illinois amended return. *Id.*; 35 ILCS 5/506(b).

Having described the limitation set by the legislature in § 905(d), it must also be recalled that the taxpayer has the burden of production and persuasion to show, for example, that the proposed alteration to an item of federal income, loss, deduction or exemption has, in fact, "been agreed to or finally determined for federal income tax purposes ..." (35 ILCS 5/506(b)), and the effect of that final federal change. *E.g.*, Balla, 96 Ill. App. 3d at 296, 421 N.E.2d at 238 ("... when a taxpayer ... seeks to take advantage of deductions or credits allowed by statute, the burden of proof is on the

taxpayer.”). What I mean here is that, although Taxpayer has not filed the required Illinois amended returns, I read § 905(d) as requiring Taxpayer’s claim to be treated the same as if it had done so. 35 ILCS 5/905(d). But just because a taxpayer files an amended return to report a change to an item of federal taxable income, deduction, etc., that would affect its Illinois income tax liability, does not mean that the Department is obliged to accept the return as proof that the federal change was, in fact, “agreed to or finally determined” 35 ILCS 5/506(b);² 35 ILCS 5/904(a)-(b); *see also* Bohannon v. Commissioner, T.C. Memo. 1997-153 (March 26, 1997) (“A tax return does not establish the correctness of the facts stated in it.”) (*citing* Seaboard Commercial Corp. v. Commissioner, 28 T.C. 1034, 1051 (1957)). Thus, if Taxpayer has offered competent and credible evidence to show that the proposed federal changes were, in fact, made, and their effect, the burden would then shift over to the Department to show the limitation within § 905(d) should not apply. 35 ILCS 5/905(d)(ii); Balla, 96 Ill. App. 3d at 296, 421 N.E.2d at 238.

As a threshold matter, however, Taxpayer has never claimed that it notified the Internal Revenue Service (IRS) that it wanted to change the year during which it incurred the § 1231 property loss. Nor has Taxpayer asserted that the IRS, on its own initiative, has adjusted either the amount of the § 1231 property loss deduction or the year during which it was properly incurred. The absence of such evidence here is determinative. Where there has been no final federal change to an item of federal income, deduction, etc., that affects a taxpayer’s Illinois income tax liability, § 506(b) does not require a

² Of course, where the IRS has either instigated the adjustment of an item of federal income, deduction or exclusion, or agreed with a taxpayer’s request for such an alteration, the taxpayer’s burden is slight. 35 ILCS 5/403(b). Such a federal determination, the Illinois General Assembly has decided, “shall be correct for purposes of [the IITA]” *Id.*

taxpayer to file an amended Illinois income tax return. 35 ILCS 5/506(b). Moreover, § 506(b) requires taxpayers to file an amended Illinois return within 120 days from the date a federal change was “agreed to or finally determined for federal income tax purposes” *Id.* But nothing within that statutory language, or elsewhere within the IITA, empowers taxpayers to modify items of federal income, deduction, etc., *unilaterally*, by filing an amended Illinois return to report, as though they were final, changes that the IRS never agreed to or finally determined. 35 ILCS 5/203(e), (h); 35 ILCS 5/401; 35 ILCS 5/403(a); 35 ILCS 5/506(b).

An example illustrates better what I mean here. Assume taxpayer A files a federal income tax return for tax year Y that reports federal taxable income in the amount of \$1,000,000, and reports that same federal taxable income on line 1 of its Illinois return for the same tax year. Now assume that taxpayer A later communicates to the Department that it has made a final determination, on its own, that its federal taxable income properly reportable for federal income tax purposes for tax year Y was really only \$500,000. Let us assume, finally, that taxpayer A has never notified the IRS of the error it now claims was made on its federal return for tax year Y. Is the Department required, for Illinois income tax purposes, to give effect to what taxpayer A now claims as being a final federal change to the amount of its federal taxable income for tax year Y? Not under the plain language of IITA §§ 203, 403, 506. *See* 35 ILCS 5/203(b), (e), (h); 35 ILCS 5/403(a); 35 ILCS 5/506(b).

In the absence of evidence that the IRS has agreed to or finally determined that the federal net losses Taxpayer originally reported for TYE 2/89 and 2/96 should be changed (35 ILCS 5/506(b)), what Taxpayer is asking the Department to do is to accept

certain factual assumptions as being true — in effect, to play a game of “let’s pretend.” But the structure of the IITA simply does not allow for such pretentions. *See* 35 ILCS 5/203(e), (h); 35 ILCS 5/401; 35 ILCS 5/403(a); 35 ILCS 506(b). Since Taxpayer took its § 1231 property loss deduction into account when determining its federal loss for TYE 2/89, §§ 401 and 403 require Taxpayer to treat that loss as having been incurred during the same year for Illinois income tax purposes. 35 ILCS 5/401; 35 ILCS 5/403(a); Bodine Electric Co., 81 Ill. 2d at 508-09, 410 N.E.2d at 831. Section 203 requires Taxpayer to start calculating its Illinois income tax liabilities for TYE 2/89 and 2/96 by taking into account the respective amounts of its federal taxable losses for those years. 35 ILCS 5/203(b), (e). Section 203(h) also prohibits Taxpayer from modifying the amounts of its federal taxable losses for those years unless such modifications are “expressly provided [for] by [§ 203].” 35 ILCS 5/203(h). Section 203 contains no provision allowing a taxpayer to change the year during which it incurred a § 1231 property loss. *See* 35 ILCS 5/203; 35 ILCS 5/401(a); Consolidated Rail Corp. v. Department of Revenue, 293 Ill. App. 3d 555, 563, 688 N.E.2d 806, 812 (1st Dist. 1997).

Since there has been no final change to Taxpayer’s federal losses for TYE 2/89 and 2/96 based on a change in the tax year during which Taxpayer incurred the § 1231 property loss, there is no statutory authority for modifying Taxpayer’s Illinois losses for the same tax years. 35 ILCS 5/506(b); *see also* 35 ILCS 5/203(h). Therefore, the Department’s calculation of the INLD available for TYE 2/07, and the NOD, need not be revised to give effect to changes that were not agreed to or finally determined, and therefore, could not be properly reported as having occurred. 35 ILCS 5/506(b); 35 ILCS 5/905(d).

Alternatively, even if the Illinois legislature intended the Department — in the absence of action by the IRS — to be able to “agree[] to or finally determine[]” that there should be some modification of an item of federal income, deduction, etc., taken into account by a taxpayer when calculating its federal taxable income for a given tax year (*see* 35 ILCS 5/506(b)), the evidence Taxpayer offered here does not show that the changes it wants the Department to make would be proper under the Code. The § 1231 property loss that Taxpayer reported to the IRS for TYE 2/89 is one that Taxpayer claimed as a result of its abandonment of a leasehold interest. Taxpayer Ex. 2.1, pp. 1, 13, 31. Federal law, both bankruptcy and income tax law, is consistent regarding the concept of abandonment. In effect, once a person has knowingly and voluntarily given a thing away, the thing belongs to the donee, and no longer belongs to the donor. *E.g.* Mason v. Commissioner, 646 F.2d 1309 (9th Cir. 1980); In re Palumbo, 271 F.Supp. 640 (U.S.D.C. W.D. VA 1967); Citron v. Commissioner, 97 T.C. 200 (1991).

Taxpayer either abandoned its leasehold interest in the Illinois property during TYE 2/89, or it did not. If it did, it must have reacquired an interest in the property prior to TYE 2/96, so that it could abandon it again during that year. If it did not, it must at a minimum explain why the IRS would agree that Taxpayer is entitled to claim a § 1231 property loss deduction during TYE 2/96 when it had already received the benefit of the same federal deduction, for the same abandoned property interest, during a year for which it was not properly entitled to such a deduction — that is, during TYE 2/89.

At hearing, Taxpayer admitted into evidence three agreements as Taxpayer Exhibit 4, which were identified as “the leasehold agreement.” Taxpayer Ex. 4; Tr. pp. 16-17. But none of the agreements in that exhibit show how Taxpayer might have

reacquired the interest it previously reported having abandoned in TYE 2/89. *See* Taxpayer Ex. 4.³ Alternatively, the agreements do not clearly reflect what interest Taxpayer might have retained to such property during the intervening years, or how Taxpayer abandoned any such retained interest during TYE 2/96. *Id.* Finally, Taxpayer offered no explanation why the IRS would allow Taxpayer to incur another § 1231 property loss deduction for abandoning the same property interest during TYE 2/96. In sum, the evidence does not support Taxpayer’s claim that, in TYE 2/96, it actually enjoyed some interest in the property that it could or actually did abandon, and which would be properly deductible as a § 1231 property loss. Taxpayer Ex. 4, *passim*.

Even if the Department has the authority to modify the amount of a federal deduction that was taken into account by a taxpayer when calculating its federal taxable income/loss for a given tax year, Taxpayer has not shown that the § 1231 property loss deduction it previously reported having incurred during TYE 2/89 was properly

³ The only agreement that appears to have become effective during TYE 2/89 is one that is merely referred to in one of the three agreements included with Taxpayer Exhibit 4. Specifically, the 1995 Agreement refers to a “Trust Agreement dated March 15, 1988 and known as Trust No. 104902-09” (Trust). Taxpayer Ex. 4 (p. 1 of 1995 Agreement). That Trust was between ABC Business and the American National Bank (Bank), as trustee. *Id.* The 1995 Agreement reflects that, pursuant to the Trust, ABC Business assigned its rights as sublessee to the property at issue to the Bank, as trustee. *Id.* So, it appears — and I stress appears, because the Trust is not part of the record — that Taxpayer considered and reported its assignment of its leasehold interest in the property to the Bank, as trustee, as its abandonment of that asset. *See* Taxpayer Exs. 2.1, 4.

The 1995 Agreement is dated during TYE 2/96. Taxpayer Ex. 4, 1995 Agreement. It is between the Bank, as trustee, and Eagle Food Centers, Inc (Eagle); Taxpayer is not a named party. *Id.* Pursuant to the 1995 Agreement, Eagle granted the Bank an option to amend the Master Lease that was in effect between Lucky Stores, Inc. (Lucky), as lessor, and ABC Business, as lessee. *Id.* Lucky had previously assigned its rights as a lessor of the Illinois property to Eagle, pursuant to the 1987 Assignment. Taxpayer Ex. 4, 1987 Assignment. Attached to the 1995 Agreement is a copy of the First Amendment to Master Lease (First Amendment) that the parties (the Bank and Eagle) agreed would be made to the Master Lease if the Bank exercised its option to amend. Taxpayer Ex. 4, 1995 Agreement. Since the First Amendment is not signed, however, the record is not clear that the Bank, as trustee, ever exercised its option to amend the Master Lease. *Id.* At first blush, therefore, the 1995 Agreement does not reflect Taxpayer’s demise, or abandonment, of anything during TYE 2/96. *Id.*

reportable under the Code as having been incurred during TYE 2/96. 35 ILCS 5/203(e), (h); 35 ILCS 5/506(b); 35 ILCS 5/905(d). Since Taxpayer has not done so, the Department's determination of the amount of the INLD that was available for Taxpayer to use for TYE 2/07 need not be revised to give effect to the changes Taxpayer wants the Department to make here. *See* Taxpayer Ex. 6; 35 ILCS 5/905(d).

Conclusion:

I recommend that the Director finalize the NOD as issued, and that the tax proposed be assessed, with interest to accrue pursuant to statute.

May 9, 2011

John E. White
Administrative Law Judge