

General Information Letter: Reduction in Illinois net losses resulting from discharge of indebtedness explained.

September 9, 2009

Dear:

This is in response to your letter dated July 22, 2009. 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:

I was referred to you by a telephone representative in the business section. They could find nothing on the subject. Our problem concerns the correct treatment of forgiveness of debt – income which is not taxable for federal taxes as long as we are insolvent. I am enclosing the pertinent parts of the federal return. I am also enclosing a draft of the Illinois return.

The total amount of debt forgiven this year is \$116,448.

RULING

Section 207(a) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/207(a)) allows corporations a deduction for Illinois net losses. For net losses incurred for taxable years ending on or after December 31, 2003, the loss may generally be carried over to the 12 taxable years following the taxable year of the loss. However, under IITA Section 207(c) the net loss and net operating loss carryover must be reduced if the taxpayer is required to reduce a federal net operating loss or federal net operating loss carryover under Internal Revenue Code (IRC) Section 108(b)(2)(A) on account of excluded discharge of indebtedness income. IITA Section 207(c) states:

(c) Notwithstanding any other provision of this Act, for each taxable year ending on or after December 31, 2008, for purposes of computing the loss for the taxable year under subsection (a) of this Section and the deduction taken into account for the taxable year for a net operating loss carryover under paragraphs (1), (2), and (3) of subsection (a) of this Section, the loss and net operating loss carryover shall be reduced in an amount equal to the reduction to the net operating loss and net operating loss carryover to the taxable year, respectively, required under Section 108(b)(2)(A) of the Internal Revenue Code, multiplied by a fraction, the numerator of which is the amount of discharge of indebtedness income that is excluded from gross income for the taxable year (but only if the taxable year ends on or after December 31, 2008) under Section 108(a) of the Internal Revenue Code and that would have been allocated and apportioned to this State under Article 3 of this Act but for that exclusion, and the denominator of which is the total amount of discharge of indebtedness income excluded from gross income under Section 108(a) of the Internal Revenue Code for the taxable year. The reduction required under this subsection (c) shall be made after the determination of Illinois net income for the taxable year in which the indebtedness is discharged.

Department Regulations § 100.2310(c) provides rules under IITA Section 207(c). A copy of the regulation is enclosed. Under Regulations § 100.2310(c)(3)(A), the reduction required under IITA

Section 207(c) to Illinois net operating loss carryovers is made after the determination of tax for the taxable year of the discharge. As a result, carryovers available to the taxable year of discharge may be included in an Illinois net loss deduction for that year, and only the remaining carryovers, if any, must be reduced. In your case, the \$172 carryover from 2003, the \$53,593 carryover from 2004, and the \$2,922 carryover from 2005 are allowed in computing your Illinois net loss deduction of \$53,765 for your taxable year ending February 28, 2009. However, the remaining \$47,221 carryover from 2005 and the \$46,955 carryover from 2008 are subject to reduction under IITA Section 207(c).

The amount of reduction to your remaining 2005 carryover and your 2008 carryover depends on the amount, if any, by which you were required to reduce any federal net operating loss carryover to your 2009 taxable year. As indicated by Regulations § 100.2310(c)(1)(B), the amount of reduction depends on the amount of the reduction required under IRC Section 108(b)(2)(A) to your federal net operating loss carryover that is allocable to Illinois. Under Regulations § 100.2310(c), the amount of your federal reduction allocable to Illinois is determined by multiplying that reduction by the percentage of your total excluded discharge of indebtedness income that would have been allocated or apportioned to Illinois but for the exclusion.

Based on the draft Form IL-1120 included with your letter, 100% of your excluded discharge of indebtedness income would have been allocated to Illinois. Therefore, 100% of any reduction you were required to make to your federal net operating loss carryovers is allocated to Illinois, and you must reduce your Illinois net loss carryovers in an amount equal to the reduction required to your federal net operating loss carryovers. For example, if you were required to reduce your federal net operating loss carryovers to 2009 by \$94,176 or more, then you must reduce both your 2005 and 2008 Illinois net operating loss carryovers to \$0. If the reduction required to your federal net operating loss carryovers is less than \$94,176, then you must reduce your Illinois net operating loss carryovers by only an equal amount, applying the reduction first to your remaining 2005 Illinois net operating loss carryover and then to your 2008 carryover. The required reduction to your Illinois net operating loss carryovers will be calculated and reported on any Schedule NLD you may file for subsequent taxable years.

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 questions regarding this GIL you may contact Legal Services at (217) 782-7055. If you have further questions related to Illinois income tax laws, visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Brian L. Stocker
Staff Attorney (Income Tax)