

General Information Letter: The Illinois Income Tax Act does not incorporate the limitations on the use of net loss carryover deductions of an acquired corporation contained in IRC Section 381(c).

September 23, 2009

Dear:

This is in response to your letter dated August 25, 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:

We respectfully request a ruling for our client, COMPANY1, Inc., based on the following set of facts:

COMPANY1, Inc. (COMPANY1) was involved with a corporate merger with COMPANY2 (COMPANY2) on December 31, 2001, with COMPANY1 being the surviving corporation. COMPANY1 has a January 31 year end and COMPANY2 had a December 31 year end.

At December 31, 2001, COMPANY2 had Illinois net operating loss carry forwards of \$273,772. COMPANY1 assumed those loss carry forwards on January 1, 2002. Enclosed is a copy of the attachment to the January 31, 2002 Form IL-1120 filed by COMPANY1.

ILCS 5/207 contains the provisions for which year to apply Illinois net operating losses. ILCS 5/405 contains the provisions for applying Illinois net loss carry overs in certain corporate acquisitions. While ILCS 5/207 indicates that Illinois has decoupled from Internal Revenue Code (IRC) 172 in calculating net operating losses and the carryover periods, ILCS 5/405 indicates that for certain corporate acquisitions, Illinois follows IRC 381.

IRC 381(c)(1)(A) indicates the acquiring corporation can first carry the acquired net operating loss to the first taxable year ending after the date of transfer. The date of transfer was December 31, 2001. The first taxable year that COMPANY1 can use COMPANY2's net operating losses is January 31, 2002.

IRC 381(c)(1)(B) indicates the net operating loss deduction in the first year of transfer (January 31, 2002) is limited to a certain amount of COMPANY1's taxable income for that year. The limitation is determined as a ratio that represents the number of days in the taxable year after the date of transfer to the total number of days in the taxable year. There were 31 days after the date of transfer. Under IRC 381, COMPANY1's taxable income that can be offset by COMPANY2's net operating loss for COMPANY1 year ended January 31, 2002, is limited to 31/365, or 8.49%. COMPANY1 taxable income for the year ended January 31, 2002 was \$80,418; 8.49% of this amount is \$6,827. The amount of COMPANY2's net operating loss used as shown on COMPANY1's 2002 Form IL-1120, Part IV, line 2 was \$6,383. A copy of page 1 and 2 of this IL-1120 is enclosed.

Upon review of COMPANY Inc.'s Illinois tax returns, the Illinois Department of Revenue sent

COMANY1 a tax notice that essentially disallows any future carryover of COMPANY2's net operating loss. Phone conversations with staff at the Illinois Department of Revenue indicate that their contention is that COMPANY1 was entitled to \$80,418 of COMANY2's net operating losses on COMPANY1 January 31, 2002 Illinois Form IL-1120, instead of the \$6,383 that was taken.

While we concur that Illinois no longer follows IRC 172 in which years to carry net operating losses to (ILCS 207), we maintain that in certain corporate reorganizations Illinois follows IRC 381 in determining the application of the net operating amount allowed (ILCS 405).

We would appreciate your legal opinion as to the application of IRC 381 with respect to Illinois loss carry forwards in certain corporate reorganizations. We have enclosed certain documents with respect to ILCS 207 and 405 and IRC 381.

RULING

Section 207 of the Illinois Income Tax Act (35 ILCS 5/207) allows a deduction for Illinois net operating losses. The section provides in relevant part as follows:

(a) If after applying all of the (i) modifications provided for in paragraph (2) of Section 203(b), paragraph (2) of Section 203(c) and paragraph (2) of Section 203(d) and (ii) the allocation and apportionment provisions of Article 3 of this Act and subsection (c) of this Section, the taxpayer's net income results in a loss;

(1) for any taxable year ending prior to December 31, 1999, such loss shall be allowed as a carryover or carryback deduction in the manner allowed under Section 172 of the Internal Revenue Code;

(2) for any taxable year ending on or after December 31, 1999 and prior to December 31, 2003, such loss shall be allowed as a carryback to each of the 2 taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 20 taxable years following the taxable year of such loss;

...

(B) The entire amount of such loss shall be carried to the earliest taxable year to which such loss may be carried. The amount of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the deductions for carryback or carryover of such loss allowable for each of the prior taxable years to which such loss may be carried.

Section 405(a) of the IITA provides for the transfer of Illinois net loss carryovers and Article 2 credits between corporations following an IRC Section 381(a) transaction. The section states:

In the case of the acquisition of assets of a corporation by another corporation described in

Section 381(a) of the Internal Revenue Code, the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, all Article 2 credits and net losses under Section 207 of the corporation from which the assets were acquired.

Interpreting Section 405(a), Department Regulations § 100.4500(b) states:

Carryovers after corporate acquisitions. IITA Section 405(a) provides that, when a corporation acquires the assets of another corporation in a transaction described in IRC Section 381(a), the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, all Article 2 credits and net losses under Section 207 of the corporation from which the assets were acquired. IRC Section 381(a) provides that, after certain specified transactions in which one corporation acquires the assets of another corporation, the acquiring corporation shall succeed to many of the tax attributes of the acquired corporation, including the right to carry forward net operating losses incurred and credits earned by the acquired corporation. Pursuant to IITA Section 405(a), any corporation that succeeds to the federal income tax attributes of another corporation under IRC Section 381(a) automatically succeeds to that corporation's IITA credit and net loss carryforwards.

Section 381(c)(1)(A) and (B) of the Internal Revenue Code, to which you refer, state as follows:

(c) Items of the distributor or transferor corporation. – The items referred to in subsection (a) are:

(1) Net operating loss carryovers. – The net operating loss carryovers determined under section 172, subject to the following conditions and limitations:

(A) The taxable year of the acquiring corporation to which the net operating loss carryovers of the distributor or transferor corporation are first carried shall be the first taxable year ending after the date of distribution or transfer.

(B) In determining the net operating loss deduction, the portion of such deduction attributable to the net operating loss carryovers of the distributor or transferor corporation to the first taxable year of the acquiring corporation ending after the date of distribution or transfer shall be limited to an amount which bears the same ratio to the taxable income (determined without regard to a net operating loss deduction) of the acquiring corporation in such taxable year as the number of days in the taxable year after the date of distribution or transfer bears to the total number of days in the taxable year.

Your letter contends that IITA Section 405(a) incorporates the provisions of IRC Section 381(c)(1)(B) in determining the amount of the net loss deduction allowed under IITA Section 207. This contention is incorrect. IITA Section 405(a) does not provide for the transfer or succession of Illinois net loss carryovers by broadly incorporating the provisions of IRC Section 381. Instead, IITA Section 405(a) merely references transactions described in IRC Section 381(a) in order to define the class of transactions in which Illinois net loss carryovers are transferred from one corporation to another corporation.

In addition, the IITA does not allow the deduction allowed under IRC Section 172, nor, for taxable years ending on and after December 31, 1999, does IITA Section 207 incorporate IRC Section 172 in

determining the manner in which Illinois net losses are carried. The provisions of IRC Section 381(c)(1) to which you refer impose conditions and limitations on the operation of IRC Section 172 and the deduction allowed under that section. Since the IITA does not incorporate IRC Section 172, the provisions of Section 381(c)(1)(B) do not limit an Illinois net loss deduction.

Department personnel were correct to advise that the entire \$80,418 net loss carryover of COMPANY2 must be first carried to COMPANY1's taxable year ending January 31, 2002.

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
Associate Counsel (Income Tax)