

General Information Letter: No subtraction is allowed to a partnership for capitalized syndication fees included in basis of the partners.

July 29, 2005

Dear:

This is in response to your letter dated July 6, 2005 in which you state the following:

We are responding to your June 25, 2005 notice on behalf of the taxpayer above (a copy of the notice is attached for your reference). We disagree with your removal of Syndication Costs as a Line 5g, Other Subtraction on the Form IL-1065 for the following reasons.

The treatment of syndication costs for tax reporting purposes is analogous to the treatment of investment interest expense. Both items are required to be separately stated on the Federal partnership income tax return. Additionally, both items result in a tax deduction to the partners and both items should be subtractions for Illinois partnership income tax purposes. The difference between these two items is that investment interest expense has a direct line item, Part 1A, line 4f, for subtractions on the Illinois partnership return, and syndication costs do not, which requires syndication costs to be reported as an other subtraction, since no line appears to be provided on Form IL-1065.

Internal Revenue Code Section 709(a) states that syndication costs incurred must be capitalized by a partnership for tax purposes. These costs cannot be deducted at the partnership level. Syndication costs increase tax capital accounts of each partner and consequently each partner's outside tax basis. Upon liquidation of the partnership, the final partnership tax return must eliminate these syndication costs from its tax basis books. Each partner individually claims his allocated share of the basis attributable to syndication costs as a capital loss on his/her individual income tax return. This individual tax treatment is governed by Internal Revenue Code Section 731(a)(2) which allows a capital loss when a partner has additional tax basis in a partnership after the partnership's liquidating distribution of money to its partners.

Because of the Federal partnership rules regarding the tax treatment of syndication costs, these costs are reported for Federal purposes as if they were a partnership asset being distributed in the final year. In reality, they are a separately stated item of capital loss since the partner is able to claim these costs on his/her individual income tax return as such. The amount to be claimed as a capital loss by each partner is referenced in the Federal K-1 footnote (please refer to a filed Federal K-1 attached).

Just as a separately stated item of capital loss on a Federal partnership income tax return is allowed as a state deduction for Illinois replacement tax purposes, so is the distributed syndication cost. The only difference between a separately stated capital loss and a distributed syndication cost relates to the mechanics of reporting these items on the Federal partnership income tax return as governed by Federal statutes. For Illinois replacement purposes, syndication costs are separately stated capital losses.

Please correct your records and abate all liabilities, penalties and interest.

According to the Department of Revenue ("Department") regulations, the Department may issue only

two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill. Adm. Code §1200, or on the website <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

Section 203(d)(1) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.) provides that the computation of a partnership's net income subject to Illinois tax begins with the partnership's federal taxable income. IITA Section 203(d)(2) provides various addition and subtraction modifications to arrive at the partnership's Illinois base income. There are no subtraction modifications for an IRC Section 731(a)(2) capital loss. Because syndication costs are not specifically listed as a subtraction modification for partnerships in IITA Section 203(d)(2), your client is unable to subtract such costs from the partnership's Illinois base income. IITA Section 203(h) states:

(h) Legislative intention.

Except as expressly provided by this Section there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise.

Pursuant to the above statutory paragraph, because no subtraction is expressly provided in Section 203 of the IITA for syndication costs whose deduction is disallowed under IRC Section 709(a), the subtraction you claim cannot be allowed.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott
Staff Attorney -- Income Tax