

TITLE 86: REVENUE

**PART 100
INCOME TAX**

SUBPART M: ACCOUNTING

Section 100.4500 Carryovers of Tax Attributes (IITA Section 405)

- a) In general. Except as expressly provided by statute, carryovers of net loss deductions and credits are only allowed to be claimed by the taxpayer that incurred the loss or earned the credit. See, e.g., *New Colonial Ice Co. v. Helvering*, 292 U.S. 435 (1934).
 - 1) A corporation that acquires the business of another corporation that has incurred net losses may not carry forward the losses incurred by the old corporation. See *New Colonial Ice Co.*
 - 2) One exception to this general rule occurs in cases where, as the result of a statutory merger, a corporation is treated as the same taxable entity as the corporations merged into it. Even then, carryovers are allowed only to the extent there is a continuity of business enterprise between the pre- and post-merger entities. See *Libson Shops, Inc. v. Koehler*, 354 U.S. 382 (1957); *Newmarket Manufacturing Co. v. U.S.*, 233 F.2d 493 (1st Cir. 1956).
 - 3) In other situations that are not covered by an express provision of the IITA, net loss deductions incurred and credits earned by one entity may be carried back or forward for use only by that same entity, and cannot be used by a different entity. This rule applies to prevent the carryover of items when an entity is deemed to be a new entity for purposes of the Internal Revenue Code and the IITA despite its continued legal existence. For example:
 - A) Company, a limited liability company wholly owned by Corporation A, has made an election under *Treas. Reg. Section 301.7701(a)* to be disregarded as a separate entity and to be treated as a division of Corporation A. On January 1, 2000, Company elects to be treated as a corporation. On that same date, Corporation A sells its interest in Company. Before January 1, 2000, Company and Corporation A are treated as a single corporation. See *Section 100.9750(b)(1)* of this Part. After the election, Company is treated as a new corporation to which Corporation A has contributed assets in exchange for stock. See *Section 100.9750(b)(2)(A)* of this Part. Because Company is treated as a new corporation separate and distinct from Corporation A, net losses incurred and credits earned by Company and Corporation A before January 1, 2000 cannot be carried forward and used by Company after that date, and

losses incurred by Company on or after January 1, 2000 cannot be carried back and used by Corporation A or Company in years prior to that date.

- B) The stock of Corporation B is sold in a transaction for which an IRC Section 338 election is made. Corporation B is treated as a new corporation that purchased all of the assets of Corporation B. Because Corporation B is treated as two separate and distinct corporations before and after the election, net losses incurred and credits earned by "old" Corporation B before the election may not be carried forward, and losses incurred by "new" Corporation B after the election may not be carried back. See Section 100.9750(b)(2)(B) of this Part.

- b) 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.
- c) Carryovers after partnership acquisitions. *In the case of the acquisition of assets of a partnership by another partnership in a transaction in which the acquiring partnership is considered to be a continuation of the partnership from which the assets were acquired under the provisions of Section 708 of the Internal Revenue Code and any regulations promulgated under that Section, the acquiring partnership 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 partnership from which the assets were acquired.* (IITA Section 405(b))
 - 1) Under Treas. Reg. Section 1.708-1(b)(2)(i), if two or more partnerships merge into one partnership, the resulting partnership is deemed the continuation of one of the merged partnerships if the partners of that merged partnership own interests totaling more than 50% of the capital and profits of the resulting partnership. In this situation, the resulting partnership will succeed to the credits and net losses of the merged partnership that is deemed to continue, if any, but not to the credits and net losses of any other of the merged partnerships. Similarly, any net loss incurred by the resulting partnership may be carried back to offset income of the merged partnership, if any, that is deemed to continue, because the two partnerships are treated as a single, continuing entity.
 - 2) Under Treas. Reg. Section 1.708-1(b)(2)(ii), if a partnership is divided into 2 or more partnerships, and the partners of one of the resulting partnerships owned an interest of more than 50% in the capital and profits of the divided partnership, that partnership is deemed to be a continuation of the divided partnership. In

such cases, the partnership, if any, that is deemed to be the continuation of the divided partnership shall succeed to the credit and net loss carryforwards of the divided partnership, and the other partnerships will not succeed to any of such credit or net loss carryforwards. Also, any net losses incurred by the partnership that is deemed be the continuation of the divided partnership may be carried back and deducted by the divided partnership.

- d) Limitations on carryovers. IRC Section 382 and the separate return limitation year consolidated return regulations under IRC Section 1502 limit the net loss and credit carryforwards available to certain corporations after a change in ownership. IITA Section 405 expressly provides that no similar limitations apply to the carryforward of Illinois net losses and credits allowed under that Section.
- e) Effective date and transition rule. Pursuant to IITA Section 405(c), the provisions of IITA Section 405 *apply to all acquisitions occurring in taxable years ending on or after December 31, 1986*. However, IITA Section 405(c)(1) provides that, *if a taxpayer's Illinois income tax liability for any taxable year, as assessed under Section 903 prior to January 1, 1999, was computed without taking into account all of the Article 2 credits and net losses under Section 207 as allowed by this Section, no refund shall be payable to the taxpayer for that taxable year as the result of allowing any portion of such credits or net losses that were not taken into account in computing the tax assessed prior to January 1, 1999*. However, IITA Section 405(c)(2) allows the taxpayer to use such credits and net losses to reduce any unpaid deficiency for those years. Further, IITA Section 405(c)(3) provides that any credit or net loss that, as a result of the operations of these provisions, *could not be taken into account either in computing the tax assessed prior to January 1, 1999 for a taxable year or in reducing a deficiency for that taxable year under paragraph (2) of subsection (c), the allowance of such credit or loss in any other taxable year shall not be denied on the grounds that such credit or loss should properly have been claimed in that taxable year under subsection (a) or (b)*. The effect of these provisions is to preserve the status quo with respect to taxes assessed prior to January 1, 1999, when the Department was asserting that carryforwards were limited pursuant to IRC Section 382, and to permit use of credit and net loss carryforwards against taxes proposed or assessed after that date without regard to any such limitations. The operation of these effective date and transition rules can be illustrated as follows:

Example 1: On December 31, 1994, Corporation X acquired the assets of Target Corporation in a reorganization described in IRC Section 368(a)(1)(C), which is a transaction described in IRC Section 381(a). As of the acquisition date, Target Corporation had net losses under IITA Section 207 of \$500 available to carry forward and research and development credits under IITA Section 201(k) of \$200 available to carry forward. In its taxable year ending December 31, 1995, Corporation X deducted all \$500 of the net losses of Target Corporation and claimed a credit for all \$200 of research and development credits of Target Corporation. The Department conducted an audit of Corporation X's 1995 return. At that time, the Department interpreted IITA Section 207 as incorporating the limitations on carryovers contained in IRC Section 382. Consistent with this interpretation of the IITA, the Department determined that Corporation X could deduct no more than \$100 per year of the net losses incurred by Target Corporation, and disallowed \$400 of the deduction claimed by Corporation X on

its 1995 return. For the same reason, the Department also disallowed all \$200 of the research and development credits claimed by Corporation X on its 1995 return.

Corporation X paid the resulting deficiency in 1998, and immediately filed a claim for refund of the deficiency. The claim had not been granted as of August 13, 1999, the effective date of Public Act 91-541 that enacted IITA Section 405. No other adjustments to the Illinois income tax liability of Corporation X have occurred since it made the payment in 1998, and the refund claim has not been granted.

Analysis of Example 1: IITA Section 405(c)(1) prohibits Corporation X from receiving a refund of taxes assessed prior to January 1, 1999 as the result of the application of IRC Section 382 limitations to the net losses of Target Corporation or of the denial of the carryforward of the research and development credits of Target Corporation. Thus, even though Corporation X had timely filed a refund claim for the deficiency it paid with respect to 1995, the claim must be denied. However, IITA Section 405(c)(3) permits Corporation X to claim the \$400 in losses and \$200 in research and development credits disallowed under IITA Section 405(c)(1) in subsequent years, including 1996 and 1997. Again, IITA Section 405(c)(1) would prohibit a refund of any taxes reported on Corporation X's timely-filed returns for 1996 and 1997, because those taxes were assessed when the returns were filed prior to January 1, 1999. Accordingly, Corporation X may claim the \$400 net loss and the \$200 credit carryforwards for 1998, the first year for which claiming these items would not result in a refund barred under IITA Section 405(c)(1) without regard to IRC Section 382 limitations. Such use is subject to all other statutes of limitations on the use of these items that apply.

Example 2: The facts are the same as in Example 1, except that Corporation X did not file a claim for refund of the 1995 deficiency. Instead, Corporation X acquiesced in the Department's position regarding IRC Section 382 limitations and claimed \$100 in net loss deductions in amended returns for 1996 and 1997. No other adjustments to tax of Corporation X have occurred since it made the payment in 1998.

Analysis of Example 2: With respect to the research and development credit earned by Target Corporation, the analysis is the same as in Example 1.

With respect to the net loss carryovers, if the refund claims for 1996 and 1997 have not been granted as of the effective date of Public Law 91-541, the analysis is the same as in Example 1. The claims for 1996 and 1997 must be disallowed pursuant to IITA Section 405(c)(1), but IITA Section 405(c)(3) allows the losses to be claimed for 1998.

If the refund claims were granted prior to the effective date of Public Law 91-541, the \$100 net loss deductions claimed in 1996 and 1997 remain valid, and Corporation X may claim the remaining \$200 in net losses in 1998, subject to all other limitations on the use of these losses.

Example 3: The facts are the same as in Example 2, except that in 2000, the Internal Revenue Service concludes an audit of Corporation X. Corporation X agrees to the audit determinations. As a result of those determinations, its Illinois net income for 1997 is increased by \$150. Pursuant to IITA Section 405(c)(2), Corporation X may use its pre-1995 net loss to offset the \$150 increase in its 1997 net income and, pursuant to

IITA Section 405(c)(3), the remaining \$50 of net losses unused as of the end of 1997 may be used to offset income in 1998.

AGENCY NOTE: IITA Section 405(c)(3) does not reopen any statute of limitations that is otherwise closed. Accordingly, if the taxpayer in Example 1, 2 or 3 above fails to file a refund claim for any year before the statute of limitations for that year expires, the claim cannot be allowed despite the provisions of IITA Section 405(c)(3).

(Source: Added at 26 Ill. Reg. 1274, effective January 15, 2002)