

IT 16-01

Tax Type: Income Tax

**Tax Issues: Net Operating Loss (Individual)
Net Operating Loss Carryback**

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

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE,
Taxpayer**

**No. XXXX
Account ID XXXX
Letter ID XXXX
XXXX
Tax Years 2010, 2011**

**Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Ralph Bassett, Esq. on behalf of the Illinois Department of Revenue; John Doe, *pro se*.

Synopsis:

On April 8, 2014, the Illinois Department of Revenue (“Department”) issued a Notice of Claim Denial for Form IL-1040-X, Amended Individual Income Tax Return to John Doe (“taxpayer”) denying the taxpayer’s refund claim for the tax year ended 12/31/11. The basis of this Notice of Claim Denial was the Department’s determination that the taxpayer had reduced his adjusted gross income to a negative number on line 1 of the taxpayer’s IL-1040-X, Amended Individual Income Tax Return. The taxpayer filed a timely protest of the Department’s Notice of Claim Denial and requested a hearing, which was held on August 3, 2015 and August 27, 2015. During the hearing, both the Department and the taxpayer submitted documentary evidence, and the taxpayer testified on his own behalf. Both the Department and the taxpayer have submitted

post hearing briefs. After a review of the evidence presented in this case, and the post hearing briefs submitted by both parties, it is recommended that the Department's Notice of Claim Denial denying the taxpayer's refund claim for the tax year ended 12/31/11 be revised as indicated below and, as revised be finalized as issued. It is also recommended that the Department's Notice of Claim Denial denying the taxpayer's refund claim for the tax year ended 12/31/10 be finalized as issued.¹ In support of this recommendation, the following "findings of fact" and "conclusions of law" are made.

Findings of Fact:

1. On or about April 17, 2014, the taxpayer requested, and was issued an Internal Revenue Service account transcript titled "Record of Account" indicating that the taxpayer's federal adjusted gross income for the tax year ended December 31, 2011 was an operating loss of (\$XXXX). Taxpayer's Exhibit ("Ex.") 2. This account transcript has been submitted to the Department. Tr. pp. 22, 23.
2. The taxpayer filed a refund claim with the federal Internal Revenue Service ("IRS"), with the taxpayer applying his net operating loss as indicated on his account transcript, resulting in the payment of a refund to the taxpayer by the IRS in the amount of \$XXXX. Taxpayer's Ex. 3.
3. On or about February 5, 2014, the taxpayer filed with the Department a form IL-1040-X, Amended Individual Income Tax Return for 2011 seeking a refund of \$XXXX. Department Ex. 1. On this form, previously reported adjusted gross income ("AGI") of

¹ This case also involves the taxpayer's protest of the Department's Notice of Claim Denial for Form IL-1040-X, Amended Individual Income Tax Return issued for the tax year ended 12/31/10. During the evidentiary hearing in this case, the taxpayer indicated that he no longer wishes to contest this Notice of Claim Denial. Tr. p. 11. Accordingly, the Department's Notice of Claim Denial issued for 2010 should be finalized as issued.

\$XXXX was reduced to a loss of (\$XXXX), the amount shown as the taxpayer's federal AGI on the taxpayer's IRS account transcript. *Id.*

4. Subsequent to the receipt of the taxpayer's amended return and account transcript as described above, the Department requested from the taxpayer a completed U.S. Form 1045, Schedule B, Application for Tentative Refund. Department Ex. 1. This document has not been submitted to the Department by the taxpayer. Department's Post-Hearing Brief ("Brief") p. 2.
5. On April 8, 2014, the Department issued to the taxpayer a Notice of Claim Denial denying the taxpayer's claim for refund for the overpayment of income tax for the tax year ended 12/31/11. Department Ex. 1.

Conclusions of Law:

The Internal Revenue Code ("IRC") permits individual taxpayers to carry a net operating loss back to the second and first preceding tax years and then forward. IRC § 172(b)(1)(A) at 26 U.S.C.A. §172(b)(1)(A). The "net operating loss" ("NOL") as defined by IRC § 172(c) at 26 U.S.C.A. §172(c) consists of the taxpayer's adjusted gross income in the loss year adjusted by deducting capital gains (but only to the extent of capital losses), non-business deductions (but only to the extent of non-business income) and no deduction is allowed for exemptions. Internal Revenue Code §172 (c), (d) at 26 U.S.C.A. § 172 (c), (d). In the instant case, the taxpayer carried forward a "net operating loss" to 2011. Tr. pp. 9, 10. The taxpayer's federal adjusted gross income ("AGI") for 2011 was adjusted to take into account this net operating loss deduction ("NOLD") resulting in adjusted gross income for federal income tax purposes for 2011 of a loss of (\$XXXX). Taxpayer's Ex. 2; Department Ex. 1. As a consequence of the taxpayer's amendment of its 2011 federal return to reflect the net operating loss deduction

described above, the taxpayer was issued a federal income tax refund for the tax year ended 12/31/11 in the amount of \$XXXX. Taxpayer's Ex. 3.

The Illinois Income Tax Act, 35 **ILCS** 5/101 *et seq.* ("IITA") provides that an individual's base income is equal to its adjusted gross income, subject to certain modifications. 35 **ILCS** 5/203. The IITA does not provide for any Illinois net operating loss deduction. Instead, the IITA relies upon the federal net operating loss deduction in computing federal AGI which is the starting point for determining an individual's Illinois base income. *Id.*

However, the Department has taken the position that federal AGI reported on line 1 of an individual's IL-1040, Individual Income Tax Return cannot be less than zero. 86 Ill. Admin. Code, section 100.2410(c)(1) ("regulation 100.2410(c)(1)") ("Taxpayers with taxable income (adjusted gross income, in the case of an individual) that is less than zero for a taxable year may offset such negative amount against any net addition modifications for the taxable year, but only to the extent the negative income has not been carried back to and deducted in any prior taxable year as a loss or deduction governed by [IITA section 203]."). See also Department Letter Ruling No. 82-0446, April 2, 1982, 1982 WL 16505 ("Letter Ruling 82-0446"). This is to prevent the double benefit that would occur if an individual carried back a current net operating loss federally, thereby reducing the amount reported as AGI during the carryback year and thereby also reducing the amount calculated as Illinois base income for the carryback year, while at the same time reporting the same loss as current negative AGI on its Illinois Individual Income Tax Return for a subsequent loss carry back or a loss carry forward year. *Id.* The Department's position enforces the prohibition against double deductions enacted by the Illinois legislature, as explained below.

The legislature recognized that calculating modified taxable income resulting from NOL deductions on federal income tax returns differs from the calculation of taxable income on Illinois income tax returns. This difference created the possibility that a taxpayer might be able to obtain a double deduction for part of an NOL. The possibility of a double deduction for part of an NOL arises because the IITA provides for addition and subtraction modifications to adjusted gross income specified in IITA § 203(a)(1) and (2). The Internal Revenue Code does not have similar adjustments. Thus, a taxpayer could offset net addition modifications on his Illinois income tax return with negative adjusted gross income created by the federal NOL deduction. However, that part of the taxpayer's NOL reduction that offsets net addition modifications would not reduce the NOL carry back or carry forward for federal purposes, so it would continue to be included in the taxpayer's carryback or carryover where it would be a deduction in arriving at AGI. Since federal AGI is the starting point in computing a taxpayer's Illinois base income, that would result in a possible double deduction of a portion of the NOL in a carryback or carryforward year.

To prevent such a result, the legislature enacted two subsections to IITA § 203. These subsections provide as follows:

(g) Double deductions. Unless specifically provided otherwise, nothing in this Section shall permit the same item to be deducted more than once.

35 ILCS 5/203(g)

(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. 35 ILCS 5/203(h)

These provisions in the statute prohibit double deductions and authorize the Department to modify a taxpayer's adjusted gross income to prevent them, as reflected in the Department's position enumerated in Regulation 100.2410(c)(1) and Department Letter Ruling 82-0446.

The taxpayer's federal transcript was the basis for his IL-1040-X, Amended Individual Income Tax Return for 2011. Compare Department Ex. 1 (taxpayer's 2011 Form IL-1040-X) and taxpayer's Ex. 2 (taxpayer's IRS account transcript). Based upon his federal transcript, the taxpayer reduced his prior AGI of \$XXXX (column A shown on the taxpayer's 2011 amended return) to a negative amount of (\$XXXX) (column B on the taxpayer's 2011 amended return). Department Ex. 1. The taxpayer then calculated his Illinois tax for 2011 based on this negative AGI amount reported on line 1 of the taxpayer's amended return, and arrived at a refund of \$4000. *Id.* In effect, the taxpayer applied the NOLD as shown on his federal transcript, reducing his previously reported AGI of \$XXXX to a negative number. For the reasons enumerated above, the reporting of AGI as a negative number on line 1 of the taxpayer's amended return is not permitted. Regulation 100.2410(c)(1), Letter Ruling 82-0446.

Moreover, the Department's 2011 Form IL-1040-X Instructions provide, in pertinent part, as follows:

Illinois does not allow you to deduct the same NOL twice. To prevent a double deduction of your NOL, your deduction for a tax year cannot be greater than the federal NOL available for deduction in that year minus the federal NOL available to carry to later years. This is the amount reported as "Modified Taxable Income" on federal Form 1045, Application for Tentative Refund, Schedule B, Line 9.

Attach copy of your federal Form 1045 Schedule B.
2011 Form IL-1040-X Instructions, p. 1.²

² The Department's regulations have the force and effect of law. *Craftmasters, Inc. v. Department of Revenue*, 269 Ill. App. 3d 934 (4th Dist. 1995). The IITA provides that "[T]he term regulations includes rules promulgated and forms prescribed by the Department." 35 ILCS 5/1501(a)(19). As a consequence of the foregoing, the instructions to the Department's forms are sources of legal authority comparable to regulations and statutes.

In the instant case, the taxpayer has failed to provide a federal Form 1045, Application for Tentative Refund, Schedule B for 2011. While the taxpayer contends that he was not required to prepare or file this schedule with the IRS and therefore should not be required to produce it to the Department, the 2011 Form IL-1040-X Instructions expressly state that, where this form is required by the Department, a *pro forma* Form 1045, Schedule B must be prepared and submitted even if the taxpayer is not required to prepare and file one by the IRS. *Id.* (“You must complete and attach U.S. 1045 Schedule B, even if you did not file a U.S. 1045 for this year.”). As a consequence of the taxpayer’s failure to prepare and submit a *pro forma* federal Form 1045 Schedule B, the taxpayer has failed to show what portion of his federal net operating loss he is allowed to carry forward to 2011.

When a taxpayer seeks to take advantage of deductions or credits allowed by statute, the burden of proof is on the taxpayer. Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296 (1st Dist. 1988), citing Bodine Electric Co. v. Allphin, 81 Ill. 2d 502 (1980). In the instant case, the taxpayer filed his amended Illinois return for 2011 to claim a refund, as authorized by IITA section 909, believing that he made an error when he filed his original return for 2011. The burden rests upon the taxpayer to prove that it is entitled to the refund it claims. Because the taxpayer has not provided the required federal Form 1045, Schedule B for 2011 pursuant to the Instructions to Form IL-1040-X, Amended Individual Income Tax Return noted above, the taxpayer has submitted insufficient proof of the amount of refund he is entitled to. Accordingly, the Department’s Notice of Claim Denial, denying the taxpayer’s refund claim must be affirmed.

While the taxpayer has provided insufficient evidence to prove that he is entitled to the refund he has claimed on his amended return, the Department has nevertheless determined that the taxpayer is entitled to a refund of \$XXXX. Department’s Brief pp. 4, 5. This refund is based

on the taxpayer's AGI as originally reported on his IL-1040, Individual Income Tax Return which the Department has treated as the correct amount of AGI for 2011. *Id.* Based on the Department's admission, I find that the taxpayer is entitled to a refund \$XXXX in accordance with the calculations indicated by Department in its brief.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's Notice of Claim Denial for 2010 be affirmed in its entirety, and that the Department's Notice of Claim Denial for 2011 be revised to grant the taxpayer a refund of \$XXXX and, as revised, be affirmed in its entirety.

Ted Sherrod
Administrative Law Judge

Date: January 13, 2016