

**Illinois Department of Revenue
Regulations**

Title 86 Part 100 Section 100.2405 Gross Income, Adjusted Gross Income, Taxable Income and Base Income Defined; Double Deductions Prohibited; Legislative Intention (IITA Section 203(e), (g) and (h))

TITLE 86: REVENUE

**PART 100
INCOME TAX**

**SUBPART E: ADDITIONS TO AND SUBTRACTIONS FROM TAXABLE INCOME OF INDIVIDUALS,
CORPORATIONS, TRUSTS AND ESTATES AND PARTNERSHIPS**

Section 100.2405 Gross Income, Adjusted Gross Income, Taxable Income and Base Income Defined; Double Deductions Prohibited; Legislative Intention (IITA Section 203(e), (g) and (h))

- a) General definitions. For the purposes of IITA Sections 203 and 803(e), and subject to the exceptions discussed in this Section, *a taxpayer's gross income, adjusted gross income or taxable income for the taxable year shall mean the amount of gross income, adjusted gross income or taxable income properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code.* (IITA Section 203(e)(1))
- b) Taxable income less than zero. *Taxable income may be less than zero.* (IITA Section 203(e)(1)) Accordingly, when the computation of a taxpayer's base income begins with its taxable income and its taxable income is negative, it may offset that negative amount against any addition modifications required to be made under IITA Section 203, consistent with the provisions of this subsection (b).
 - 1) Taxable years ending on or after December 31, 1986.
 - A) For taxable years ending on or after December 31, 1986, *net operating loss carry-forwards from taxable years ending prior to December 31, 1986 may not exceed the sum of federal taxable income for the taxable year before net operating loss deduction, plus the excess of addition modifications for the taxable year.* (IITA Section 203(e)(1))
 - B) Example 1. In its taxable year ending December 31, 1986, Corporation A properly reports a federal net operating loss (FNOL) of \$100,000, all of which is available to carry forward to its taxable years ending on or after December 31, 1987 for federal income tax purposes. Corporation A has addition modifications for its taxable year ending December 31, 1986 that exceed its subtraction modifications for that year by \$5,000. For Illinois income tax purposes, the federal net operating loss available to carry forward is \$95,000 (the \$100,000 federal net operating loss minus the \$5,000 in excess addition modifications). In its taxable year ending

December 31, 1987, Corporation A deducts \$97,000 of the federal net operating loss. The remainder is deducted in its taxable year ending December 31, 1988. For purposes of IITA Section 203, Corporation A's taxable income for the taxable year ending December 31, 1987 is computed without allowing \$2,000 of the federal net operating loss deduction taken in that year and its taxable income for December 31, 1988 is computed without allowing any of the \$3,000 federal net operating deduction. In order to avoid a double benefit, Corporation A must add back the ineligible \$2,000 and \$3,000 of FNOL for Illinois purposes on its Illinois return for 1987 and 1988, respectively.

- 2) Taxable years ending before December 31, 1986.
 - A) For taxable years ending prior to December 31, 1986, *taxable income may never be an amount in excess of the net operating loss for the taxable year as defined in Internal Revenue Code section 172(c) and (d), provided that when taxable income of a corporation (other than a subchapter S corporation), trust, or estate is less than zero and addition modifications, other than those provided by IITA 203(b)(2)(E) or (c)(2)(E) for trusts and estates, exceed subtraction modifications, an addition modification must be made under those subparagraphs for any other taxable year to which taxable income less than zero (net operating loss) is applied under Internal Revenue Code section 172 or IITA Section 203(e)(2)(E) in conjunction with Internal Revenue Code section 172. (IITA Section 203(e)(1))*
 - B) For application of this provision, see Sections 100.2230 and 100.2410.
 - 3) Pre- and post-1986 net losses are discussed in detail at 86 Ill. Adm. Code 100.2200 through 100.2250 and individual net losses are specifically discussed at Section 100.2410.
- c) Special rules regarding certain taxpayers. Many taxpaying entities do not calculate federal taxable income on a federal taxable return or use a special variation of federal taxable income. For these taxpayers, IITA Section 203(e)(2) defines federal taxable income. Thus, for purposes of IITA Section 203, the taxable income properly reportable by the following taxpayers for federal income tax purposes shall mean:
- 1) Certain life insurance companies – *for life insurance companies taxable under Internal Revenue Code section 801, life insurance company taxable income, plus the amount of distribution from pre-1984 policyholder surplus accounts as calculated under Internal Revenue Code section 815a. (IITA Section 203(e)(2)(A));*
 - 2) Mutual insurance companies – *for mutual insurance companies taxable under Internal Revenue Code section 831, insurance company taxable income. (IITA Section 203(e)(2)(B));*
 - 3) Regulated investment companies (RICs) – *for RICs taxable under Internal Revenue Code section 852, investment company taxable income. (IITA Section 203(e)(2)(C));*

- 4) Real estate investment trusts (REITs) – *for REITs taxable under Internal Revenue Code section 857, REIT taxable income.* (IITA Section 203(e)(2)(D));
- 5) Consolidated corporations – *for a corporation that is a member of an affiliated group of corporations filing a federal consolidated income tax return for the taxable year, taxable income determined as if such corporation had filed a separate return federally for the taxable year and for each preceding taxable year for which it was a member of an affiliated group and also determined as if the election provided under Internal Revenue Code section 243(b)(2) had been in effect for all such years.* (IITA Section 203(e)(2)(E)). However, for purposes of computing the combined taxable income and combined base income of a unitary business group for purposes of IITA Sections 304(e) and 502(e), Section 100.5270 requires the unitary business group to use the federal consolidated return regulations;
- 6) Cooperatives – *for cooperative corporations or associations, taxable income of such organization determined in accordance with Internal Revenue Code sections 1381 through 1388, inclusive.* (IITA Section 203(e)(2)(F));
- 7) Subchapter S corporations – Subchapter S corporations are not generally subject to federal income tax but instead act as conduits through which items of gain, loss, income and deduction flow to their owners. Accordingly, a special rule for computing "taxable income" is necessary to enable them to compute their Illinois base income for purposes of determining their Illinois Personal Property Tax Replacement Income Tax liability under IITA Section 201(c) and (d).
 - A) Election in effect. For subchapter S corporations for which there is in effect an election for the taxable year under Internal Revenue Code section 1362, "taxable income" means *taxable income determined in accordance with Internal Revenue Code section 1363(b), except that taxable income shall also take into account those items that are required to be separately stated under Internal Revenue Code section 1363(b)(1).* (IITA Section 203(e)(2)(G)(i))
 - B) Items required to be separately stated under Internal Revenue Code section 1363(b)(1), as listed in 26 CFR 1.1366-1(a)(2), include:
 - i) The corporation's combined net amount of gains and losses from sales or exchanges of capital assets;
 - ii) The corporation's combined net amount of gains and losses from sales or exchanges of property used in the trade or business and involuntary conversions;
 - iii) Charitable contributions paid by the corporation within the taxable year of the corporation;
 - iv) The taxes described in Internal Revenue Code section 901 that have been paid (or accrued) by the corporation to foreign countries or to possessions of the United States;

- v) Each of the corporation's separate items involved in the determination of credits against tax allowable under part IV of subchapter A (section 21 et seq.) of the Internal Revenue Code, except for any credit allowed under Internal Revenue Code section 34 (relating to certain uses of gasoline and special fuels);
 - vi) Each of the corporation's separate items of gains and losses from wagering transactions (Internal Revenue Code section 165(d)); soil and water conservation expenditures (Internal Revenue Code section 175); deduction under an election to expense certain depreciable business expenses (Internal Revenue Code section 179); medical, dental, etc., expenses (Internal Revenue Code section 213); the additional itemized deductions for individuals provided in part VII of subchapter B of the Internal Revenue Code (Internal Revenue Code section 212 et seq.); and any other itemized deductions for which the limitations on itemized deductions under Internal Revenue Code section 67 or 68 applies;
 - vii) Any of the corporation's items of portfolio income or loss, and related expenses, as defined in 26 CFR 1.469-0 through 11 (2007) under Internal Revenue Code section 469;
 - viii) The corporation's tax-exempt income. For purposes of subchapter S, tax-exempt income is income that is permanently excludible from gross income in all circumstances in which the applicable provision of the Internal Revenue Code applies. For example, income that is excludible from gross income under Internal Revenue Code section 101 (certain death benefits) or Internal Revenue Code section 103 (interest on state and local bonds) is tax-exempt income, while income that is excludible from gross income under Internal Revenue Code section 108 (income from discharge of indebtedness) or Internal Revenue Code section 109 (improvements by lessee on lessor's property) is not tax-exempt income; and
 - ix) Any other item identified in guidance (including forms and instructions) issued by the IRS Commissioner as an item required to be separately stated.
- C) Treatment of items required to be separately stated under Internal Revenue Code section 1363(b)(1). Many items are required to be separately stated because their deduction is limited by the taxable income or adjusted gross income of the taxpayer, and this limitation must be determined by each shareholder rather than by the subchapter S corporation. IITA Section 203(e)(2)(G) permits the deduction of these items without imposing the limitations that could apply to the shareholder. For example, charitable deductions that must be separately stated are deductible by a subchapter S corporation without regard to the limitations under Internal Revenue Code section 170(b).

- D) Items not separately stated under Internal Revenue Code section 1363(b), and that cannot be taken into account in computing "taxable income" for purposes of IITA Section 203, include:
- i) Internal Revenue Code section 199(d)(1)(A) provides that the deduction under Internal Revenue Code section 199 for the domestic production activities income of a subchapter S corporation are taken at the shareholder level, rather than by the corporation. Because these deductions are separately stated under this provision and not under Internal Revenue Code section 1363(b)(1), a subchapter S corporation may not take these deductions in computing its taxable income for purposes of IITA Section 203.
 - ii) Internal Revenue Code section 613A(c)(11) provides that percentage depletion deductions for oil and gas property of a subchapter S corporation is computed separately for each shareholder. Because these deductions are separately stated under this provision and not under Internal Revenue Code section 1363(b)(1), a subchapter S corporation may not take these deductions in computing its taxable income for purposes of IITA Section 203. However, in the case of any subchapter S corporation that deducted percentage depletion on oil and gas properties on any return filed prior to March 31, 2008 in reliance on the return instructions for the Form IL-1120-ST, any increase in Illinois income tax liability that would result from disallowing the percentage depletion deduction for oil and gas property for that year shall be abated under Section 4(c) of the Taxpayers' Bill of Rights Act [20 ILCS 2520/4(c)].
- E) Election not in effect. For subchapter S corporations for which there is in effect an election to opt out of the provisions of the subchapter S Revision Act of 1982 and have applied instead the prior federal subchapter S rules as in effect on July 1, 1982, "taxable income" *means the taxable income of such corporation determined in accordance with the federal subchapter S rules as in effect on July 1, 1982.* (IITA Section 203(e)(2)(G)(ii));
- 8) Partnerships – Partnerships are not generally subject to federal income tax, but instead act as conduits through which items of gain, loss, income and deduction flow to their owners. Accordingly, a special rule for computing "taxable income" is necessary to enable partnerships to compute their Illinois base income for purposes of determining their Illinois Personal Property Tax Replacement Income Tax liability under IITA Section 201(c) and (d). For partnerships, "taxable income" is *taxable income determined in accordance with Internal Revenue Code section 703, except that taxable income shall take into account those items that are required by Internal Revenue Code section 703(a)(1) to be separately stated but would be taken into account by an individual in calculating his taxable income.* (IITA Section 203(e)(2)(H))
- A) Items required to be separately stated under Internal Revenue Code section 703(a)(1). Internal Revenue Code section 703(a)(1) provides that

items listed in Internal Revenue Code section 702(a) must be separately stated. These items are:

- i) gains and losses from sales or exchanges of capital assets held for not more than 1 year;
- ii) gains and losses from sales or exchanges of capital assets held for more than 1 year;
- iii) gains and losses from sales or exchanges of property described in Internal Revenue Code section 1231 (relating to certain property used in a trade or business and involuntary conversions);
- iv) charitable contributions (as defined in Internal Revenue Code section 170(c));
- v) dividends entitled to capital gains treatment under Internal Revenue Code section 1(h)(11) or to the corporate dividends-received deduction under part VIII of subchapter B of the Internal Revenue Code;
- vi) taxes for which the foreign tax credit may be allowed under Internal Revenue Code section 901, paid or accrued to foreign countries and to possessions of the United States; and
- vii) other items of income, gain, loss, deduction or credit to the extent provided by regulations prescribed by the Secretary of the Treasury (see 26 CFR 1.702-1).

B) Treatment of items required to be separately stated under Internal Revenue Code section 703(a)(1). Many items are required to be separately stated because their deduction is limited by the taxable income or adjusted gross income of the taxpayer, and this limitation must be determined by each partner rather than by the partnership. IITA Section 203(e)(2)(H) permits the deduction of these items without imposing the limitations that could apply to the partner. For example, charitable deductions that must be separately stated are deductible by a partnership without regard to the limitations under Internal Revenue Code section 170(b).

C) Items not separately stated under Internal Revenue Code section 703(a)(1), and that cannot be taken into account in computing "taxable income" for purposes of IITA Section 203, include:

- i) Internal Revenue Code section 199(d)(1)(A) provides that the deduction under Internal Revenue Code section 199 for the domestic production activities income of a partnership is taken at the partner level, rather than by the partnership. Because these deductions are separately stated, this provision and not the provision under Internal Revenue Code section 703(a)(1), a partnership may not take these deductions in computing its taxable income for purposes of IITA Section 203;

- ii) Internal Revenue Code section 613A(c)(11) provides that percentage depletion deductions for oil and gas property of a partnership is computed separately for each partner. Because these deductions are separately stated, this provision and not the provision under Internal Revenue Code section 703(a)(1), a partnership may not take these deductions in computing its taxable income for purposes of IITA Section 203. However, in the case of any partnership that deducted percentage depletion on oil and gas properties on any return filed prior to March 31, 2008 in reliance on the return instructions for the Form IL-1065, any increase in Illinois income tax liability that would result from disallowing the percentage depletion deduction for oil and gas property for that year shall be abated under Section 4(c) of the Taxpayers' Bill of Rights Act [20 ILCS 2520/4(c)]; and
 - iii) Internal Revenue Code section 108(a) provides that a taxpayer in bankruptcy or that is insolvent does not recognize income from discharge of indebtedness. Internal Revenue Code section 108(d)(6) provides that, when indebtedness of a partnership is discharged, this exemption applies only at the partner level. Accordingly, the exemption in Internal Revenue Code section 108(a) does not apply in determining the taxable income of a partnership;
- 9) Electing small business trust (ESBT). An ESBT that owns both stock in one or more subchapter S corporations and other property is treated as two separate trusts under Internal Revenue Code section 641. However, the IRS practice is to require the ESBT to file a single return and pay tax on the income from both sources. In these cases, the income of the ESBT derived by the ESBT from investments in subchapter S corporations is not reported, but rather the tax liability attributable to that income is computed separately and added to the tax liability computed for the other property of the ESBT. In order to allow the ESBT to file a single Illinois income tax return, an ESBT that owns both stock in subchapter S corporations and other property shall include income from both sources in its taxable income for purposes of IITA Section 203.
- d) Special rule regarding recapture of business expense on disposition of asset or business. *Notwithstanding any other law to the contrary, if in prior years income from an asset or business has been classified as business income and in a later year is demonstrated to be non-business income, then all expenses, without limitation, deducted in such later year and in the two immediately preceding taxable years related to that asset or business that generated the non-business income, shall be added back and recaptured as business income in the year of the disposition of the asset or business. Such amount shall be apportioned to Illinois using the greater of the apportionment fraction computed for the business under IITA Section 304 for the taxable year or the average of the apportionment fractions computed for the business under IITA Section 304 for the taxable year and for the two immediately preceding taxable years.* (IITA Section 203(e)(3)) This provision is effective for tax years ending on or after July 30, 2004 (the effective date of Public Act 93-840).

- 1) IITA Section 203(e)(3) requires recapture of expenses treated as business expenses in a taxable year for which the taxpayer has made an election under IITA Section 1501(a)(1) to treat all of its income (other than employee compensation) as business income whenever, in a subsequent year, the taxpayer fails to make that election, so that income from an asset is treated as business income in the earlier year and as nonbusiness income in the subsequent year.
 - 2) IITA Section 203(e)(3) shall not require the recapture of business expenses passed through to a partner in any taxable year by a partnership that qualifies as an investment partnership under IITA Section 1501(a)(11.5) in a subsequent taxable year, causing all income of the partnership to be characterized as nonbusiness income under IITA Section 305(c-5).
 - 3) IITA Section 203(e)(3) shall not require a partner, a shareholder in a subchapter S corporation, or a beneficiary of a trust or estate to recapture business expenses passed through by the partnership, subchapter S corporation, trust or estate for a taxable year merely because nonbusiness income is passed through the partnership, subchapter S corporation, trust or estate in a subsequent year. However, recapture of those business expenses passed through in a taxable year shall be required by the partner, shareholder or beneficiary if the partnership, subchapter S corporation, trust or estate is required to recapture business expenses for that taxable year or if the business expenses were passed through in the same year that the partnership, subchapter S corporation, trust or estate also passed through nonbusiness income that the partner, shareholder or beneficiary elected to treat as business income under IITA Section 1501(a)(1) and the partner, shareholder or beneficiary fails to make that election with respect to nonbusiness income passed through by the partnership, subchapter S corporation, trust or estate in a subsequent year.
- e) Illinois base income defined. "Illinois base income" is the amount determined by applying addition and subtraction modifications specifically authorized under the IITA to either federal adjusted gross income (in the case of individuals) or federal taxable income (in the case of all other taxpayers). An item taken into account on the federal income tax return after the computation of federal taxable income or federal adjusted gross income will not be reflected on the corresponding Illinois income or replacement income tax return unless specifically authorized in the IITA. For example, itemized deductions, which are taken on Schedule A to the U.S. 1040 after federal adjusted gross income has already been calculated, are not reflected in Illinois base income.
- f) Double deductions prohibited. No item of deduction may be taken into account twice in the calculation of Illinois base income unless specifically authorized under the IITA. If a subtraction modification applies to an item that is already excluded or deducted in computing adjusted gross income or federal taxable income, or to which another subtraction applies, it will be disallowed. (See IITA Section 203(g).)
- g) Legislative intention. IITA Section 203(h) provides that, unless specifically authorized under the IITA Section 203, *no modifications or limitations on the amounts of income, gain, loss or deduction shall be 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 Illinois*

base income and net income (defined at Section 100.2050) for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise.

(Source: Added at 32 Ill. Reg. 6055, effective March 25, 2008)