

General Information Letter: Illinois has no equivalent of IRC Section 642(h) that would allow a beneficiary of a terminated estate to claim a carryforward deduction of an Illinois net loss incurred by the estate.

June 22, 2010

Dear:

The original Illinois income tax returns filed by the TRUST for 2007 and 2008, and the amended return filed for 2007, together with various correspondence between your firm and the Department, have been forwarded to me for review. The nature of the information you have provided require that we respond with a General Information Letter, which 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 found on the Department's web site at www.tax.illinois.gov. If you wish to contest the determination of the Department, the TRUST will have to either pay the tax assessed by the Department under protest as provided in the State Officers and Employees Money Disposition Act, 30 ILCS Act 230, and proceed to court, or pay the tax assessed by the Department and file a refund claim. When the claim is disallowed, the TRUST may protest the disallowance and request a hearing.

Background

On its 2007 Form IL-1041, Fiduciary Income and Replacement Tax Return, the TRUST claimed an Illinois net loss carryover deduction of \$85,972, which reduced its net income to zero. The Schedule INL subsequently provided showed a carryforward of an Illinois net loss in the amount of \$115,071 from 2005, offsetting income of \$85,972 and leaving \$29,099 to be carried forward. On its 2008 Form IL-1041, Fiduciary Income and Replacement Tax Return, the TRUST A claimed a deduction for the remaining \$29,099 in Illinois net loss.

Because the TRUST had not previously reported an Illinois net loss, the carryforward deduction for 2007 was disallowed. In subsequent conversations with representatives of the Department, it was disclosed that the net loss being carried forward had been incurred by an estate whose federal net operating loss had been carried forward by the TRUST under the provisions of Section 642(h) of the Internal Revenue Code, which provides:

If on the termination of an estate or trust, the estate or trust has -

(1) a net operating loss carryover under section 172 or a capital loss carryover under section 1212, or

(2) for the last taxable year of the estate or trust deductions (other than the deductions allowed under subsections (b) or (c)) in excess of gross income for such year,

then such carryover or such excess shall be allowed as a deduction, in accordance with regulations prescribed by the Secretary, to the beneficiaries succeeding to the property of the estate or trust.

The deduction was disallowed because Illinois law has no equivalent of Section 642(h) of the Internal Revenue Code that would allow the TRUST to deduct an Illinois net loss incurred by an estate.

In response to this determination, the TRUST filed a Form IL-1040-X, Amended Fiduciary Income and Replacement Tax Return, for 2007. In a cover letter dated September 29, 2009, your firm explained the revisions reported as follows:

Since the Illinois Department of Revenue has taken the stance that the NOL carryforward can not come from the Estate to the following Trust, we have taken the stance that the trust would not incur a tax liability because of the status of the trust. The trust in question is an Irrevocable Simple trust which requires all income to be passed to the beneficiary. The amended return reflects that without the NOL, the income would pass through and be taxable to the beneficiary of the trust.

The Form IL-1040-X shows that the federal taxable income of the TRUST, as originally reported on the Form IL-1040, was a negative \$75,046. A federal net operating deduction of \$160,035 claimed on the federal return had been added back, leaving the TRUST with positive Illinois base income after other modifications were made. The Form IL-1040-X reported the "corrected amount" of federal taxable income to be a negative \$983, with no add-back for any federal net operating loss deduction. No Illinois income or replacement tax had been paid by the TRUST, so neither the original nor the amended return showed an overpayment of tax.

Response

Under Section 203(c)(1) of the Illinois Income Tax Act (35 ILCS 5/203), the computation of a trust's "net income" taxed by Illinois begins with the trust's federal taxable income. Under Section 203(c)(2), various addition and subtraction modifications are then made, and the resulting "base income" is then allocated and apportioned to Illinois. Section 203(c)(2)(D) requires a trust to add back "any net operating loss deduction taken in arriving at taxable income, other than a net operating loss carried forward from a taxable year ending prior to December 31, 1986."

Section 203(e)(1) defines "taxable income" to mean "taxable income properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code." Section 203(h) provides that no modification may be made to taxable income unless expressly provided in Section 203.

Section 207(a) of the Illinois Income Tax Act (35 ILCS 5/207) provides:

If after applying all of the (i) modifications provided for in paragraph (2) of . . . Section 203(c) . . . (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 . . .

(3) for any taxable year ending on or after December 31, 2003, such loss shall be allowed as a net operating loss carryover to each of the 12 taxable years following the taxable year of such loss.

Section 405(a) of the Illinois Income Tax Act (35 ILCS 5/405) provides that a corporation may succeed to the Illinois net loss carryovers of another corporation when it acquires the assets of that corporation in a transaction described in Section 381(a) of the Internal Revenue Code. However, there is no provision in the Illinois Income Tax Act similar to Section 642(h) of the Internal Revenue Code, that would permit a beneficiary of a terminated estate to succeed to an unused Illinois net loss of the estate.

Under these provisions, the TRUST is required to compute its 2007 Illinois net income by starting with the negative \$75,046 in federal taxable income reported on its federal income tax return for the year, and adding back the \$160,035 federal net operating loss deduction claimed on its federal income tax return. Section 203(e)(1) does not permit the recomputation of federal taxable income as if no federal net operating loss deduction had been claimed. Because the TRUST had incurred no Illinois net loss in prior years, no carryforward deduction was allowable in 2007. The adjustments made by the Department to the original return are therefore correct.

As stated above, this is a general information letter which 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 are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax