

General Information Letter: Corporation with a taxable year ending May 31, 2011, taxable year that realizes its net income for that year prior to January 1, 2011, is subject to tax at the pre-2011 rates, but may not deduct a net loss carryforward.

August 1, 2011

Dear:

This is in response to your letter dated July 23, 2011. The nature of your letter and the information provided require that we respond with a General Information Letter (GIL). A GIL 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 accessed from the Department's web site at www.Iltax.com.

Your letter states:

I am writing to get a legal opinion on two issues concerning a corporation that was sold two months after its May 31, 2010 fiscal year end.

Facts:

- 1) The corporation had a loss for the fiscal year end May 31, 2010.
- 2) The corporation sold its physical assets and goodwill on July 30, 2010.
- 3) The recaptured depreciation exceeded the selling price on the equipment and vehicles sold and therefore the selling price was all recorded as ordinary income as of the date of sale on July 30, 2010, but will be reported on the May 31, 2011 income tax return.
- 4) The corporation remains open because the buying company is paying the sale proceeds over a three year period and goodwill is being reported on the installment method.

Questions:

- 1) Since the corporation was sold July 30, 2010 and the selling price of the physical assets was all recorded as ordinary income (all prior to January 1, 2011), is the corporation entitled to report all of its income on the Schedule SA in column A, pre 1/1/2011 figures?
- 2) Since the corporation will not have any taxable income to report after the December 31, 2004 loss suspension date, when does the corporation get to deduct the May 31, 2010 net operating loss?

My thought would be that it can be deducted in the final year that it has operating income and income from the sale of the business which would be May 31, 2011.

If you agree with me on this, how do I show the net operating loss deduction on the May 31, 2011 income tax return so that it won't be questioned?

RULING

Section 201(b)(9) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/201(b)(9)) provides as follows regarding the corporate income tax rate:

In the case of a corporation, for taxable years beginning prior to January 1, 2011, and ending after December 31, 2010, an amount equal to the sum of (i) 4.8% of the taxpayer's net income for the period prior to January 1, 2011, as calculated under Section 202.5, and (ii) 7% of the taxpayer's net income for the period after December 31, 2010, as calculated under Section 202.5

IITA Section 202.5 states in part:

(b) Election to attribute income and deduction items specifically to the respective portions of a taxable year prior to January 1 of any year and after December 31 of the preceding year. In the case of a taxpayer with a taxable year beginning prior to January 1 of any year and ending after December 31 of the preceding year, the taxpayer may elect, instead of the procedure established in subsection (a) of this Section, to determine net income on a specific accounting basis for the 2 portions of the taxable year:

(1) from the beginning of the taxable year through December 31; and

(2) from January 1 through the end of the taxable year.

The election provided by this subsection must be made in form and manner that the Department requires by rule, and must be made no later than the due date (including any extensions thereof) for the filing of the return for the taxable year, and is irrevocable.

(c) If the taxpayer elects specific accounting under subsection (b):

(1) there shall be taken into account in computing base income for each of the two portions of the taxable year only those items earned, received, paid, incurred or accrued in each such period;

(2) for purposes of apportioning business income of the taxpayer, the provisions in Article 3 shall be applied on the basis of the taxpayer's full taxable year, without regard to this Section;

(3) the net loss carryforward deduction for the taxable year under Section 207 may not exceed combined net income of both portions of the taxable year, and shall be used against the net income of the portion of the taxable year from the beginning of the taxable year through December 31 before any remaining amount is used against the net income of the latter portion of the taxable year.

IITA Section 1501(a)(15) states that the terms "paid," "incurred," and "accrued" refer to the taxpayer's method of accounting upon which base income is determined under the IITA. IITA Section 402(a) states regarding a taxpayer's method of accounting, in part as follows:

For purposes of the tax imposed by this Act, a person's method of accounting shall be the same as

such person's method of accounting for federal income tax purposes.

Under the installment method of accounting for federal income tax purposes, income from a disposition is recognized proportionately as payments are received. 26 U.S.C. 453(c).

Section 207 of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/207) states in part:

(a) If after applying all of the (i) modifications provided for in paragraph (2) of Section 203(b), paragraph (2) of Section 203(c) and paragraph (2) of Section 203(d) and (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;

- (1) for any taxable year ending prior to December 31, 1999, such loss shall be allowed as a carryover or carryback deduction in the manner allowed under Section 172 of the Internal Revenue Code;
- (2) for any taxable year ending on or after December 31, 1999 and prior to December 31, 2003, such loss shall be allowed as a carryback to each of the 2 taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 20 taxable years following the taxable year of such loss; and
- (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, except as provided in subsection (d).

...

(d) In the case of a corporation (other than a Subchapter S corporation), no carryover deduction shall be allowed under this Section for any taxable year ending after December 31, 2010 and prior to December 31, 2014; provided that, for purposes of determining the taxable years to which a net loss may be carried under subsection (a) of this Section, no taxable year for which a deduction is disallowed under this subsection shall be counted.

Applying the above to the facts set forth in your letter, if you elect the cut-off method under IITA Section 202.5(b), then you must allocate to that portion of the taxable year prior to January 1 only the items of income, gain, deduction, and loss taken into account before January 1 under your method of accounting for federal income tax purposes. Accordingly, if you elect to apply the installment method to the July 30, 2010 asset sale, gain realized from that sale may be assigned to the pre-January 1 portion of your taxable year only to the extent that gain is proportionately recognized from payments received prior to January 1 of the taxable year. Gain recognition attributable to payments received after December 31 of the taxable year must be assigned to such portion of the taxable year and therefore subject to the 7% rate of tax.

Regarding the 2010 net operating loss, pursuant to Section 207(d), no net operating loss deduction otherwise allowed a corporate taxpayer (other than an S corporation) under subsection (a)(1), (2), or (3) for taxable years ending after December 31, 2010 and prior to December 31, 2014, shall be allowed. There are no exceptions to the rule in subsection (d) for the final taxable year of a

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corporation in which it has operating income or otherwise. Therefore, you are not allowed a net operating loss deduction for your taxable year ending May 31, 2011.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department.

Sincerely,

Brian L. Stocker
Associate Counsel (Income Tax)