

Technical termination of a partnership triggers the requirements in IITA Section 203 (d)(2)(D-6) and (P) to reverse the bonus depreciation modifications reported by the taxpayer in prior years.

September 27, 2013

IT 13-0010-GIL

Re: Illinois replacement tax

Dear Xxxxx:

This is in response to your letter dated August 30, 2013 regarding the Illinois personal property tax replacement income tax. 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](http://www.Iltax.com).

Your letter states as follows:

We are writing to request a General Information Letter under 2 Ill. Adm. Code Sec. 1200.120, on behalf of our client ("Taxpayer or Partnership") in relation to their Illinois Personal Property Tax Replacement Income Tax ("Replacement Tax") liability. Specifically, the Illinois tax issue on which we would like the Department of Revenue's guidance is the addition modification under 35 ILCS 5/203(d)(2)(D-6) for bonus depreciation, and the subtraction modification under 35 ILCS 5/203(d)(2)(P) for bonus depreciation, as it relates to a period in which Partnership has a change in ownership interest which triggers a technical termination under Internal Revenue Code (IRC) § 708(b). Immediately below are the specific detailed facts, which we believe would be relevant to this issue.

Taxpayer is a partnership for federal and Illinois income tax purposes. For federal income tax purposes, Partnership claimed 50% bonus depreciation on assets placed in service during 2009, 2010, and 2011. Partnership's Illinois IL-1065 tax return added back the 50% bonus depreciation for each of these years, pursuant to 35 ILCS 5/203(d)(2)(D-5). Partnership also made subtraction modifications to its base income for bonus depreciation for the 50% bonus depreciation assets placed into service, pursuant to 35 ILCS 5/203(d)(2)(O). In the aggregate, the addition modifications are greater than the subtraction modifications.

Within a 12 month period partners exchanged over 50 percent of the total interests in Partnership. As a result Partnership was considered to technically terminate under IRC § 708(b).

For the reasons stated in our analysis below, we respectfully request guidance regarding the following:

That upon the technical termination under IRC § 708(b)(1)(B), the assets of the Partnership are deemed to be transferred, and the Partnership should add back any previous bonus depreciation subtractions and subtract any previous bonus depreciation additions under 35 ILCS 5/203(d)(2)(D-6) and (P), respectively, in the period of the technical termination.

35 ILCS 5/203(d)(2)(D-6) provides for an addition modification,

If the taxpayer sells, transfers, abandons, or otherwise disposes of property for which the taxpayer was required in any taxable year to make an addition modification under subparagraph (D-5), then an amount equal to the aggregate amount of the deductions taken in all taxable years under subparagraph (O) with respect to that property.

If the taxpayer continues to own property through the last day of the last tax year for which the taxpayer may claim a depreciation deduction for federal income tax purposes and for which the taxpayer was allowed in any taxable year to make a subtraction modification under subparagraph (O), then an amount equal to that subtraction modification.

The taxpayer is required to make the addition modification under this subparagraph only once with respect to any one piece of property.

35 ILCS 5/203(d)(2)(P) provides for a deduction or subtraction modification,

If the taxpayer sells, transfers, abandons, or otherwise disposes of property for which the taxpayer was required in any taxable year to make an addition modification under subparagraph (D-5), then an amount equal to that addition modification.

If the taxpayer continues to own property through the last day of the last tax year for which the taxpayer may claim a depreciation deduction for federal income tax purposes and for which the taxpayer was required in any taxable year to make an addition modification under subparagraph (D-5), then an amount equal to that addition modification.

The taxpayer is allowed to take the deduction under this subparagraph only once with respect to any one piece of property.

This subparagraph (P) is exempt from the provisions of Section 250.

Under IRC Section 708(b)(1)(B), a partnership will terminate if “within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.” Upon a technical termination, the following is deemed to occur:

The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership and, immediately thereafter, the terminated partnership distributes interests in the new partnership to the purchasing partner and the other remaining partners in proportion to their respective interests in the terminated partnership in liquidation of the terminated partnership, either for the continuation of the business by the new partnership or for its dissolution and winding up.

Upon the deemed transfer of property under IRC § 708(b)(1)(B), the depreciation of the partnership’s assets for federal income tax purposes restarts for the new partnership, under IRC § 168(i)(7)(B). The tax basis of the property subject to depreciation in the new partnership carries over from the terminating partnership. This tax basis is net of the depreciation, including bonus depreciation taken by the terminating partnership.

The provisions in sections 35 ILCS 5/203(d)(2)(D-6) and (P) are triggered because a technical termination results in a deemed transfer of property from the existing partnership to a new partnership under IRC § 708(b)(1)(B). Therefore, the Illinois bonus depreciation addition and subtraction modifications previously made by the Partnership should be subtracted and added back, respectively, in the period of the technical termination.

## **RULING**

Section 203(e)(1) of the Illinois Income Tax Act (“IITA” 35 ILCS 5/203(e)(1)) provides that for purposes of Section 203 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. This provision, which couples the Illinois tax base to the federal tax base, is complimented by three other rules. First, IITA Section 401 provides that a taxpayer’s taxable year under the IITA is generally the same as the taxpayer’s taxable year for federal income tax purposes. Second, IITA Section 402 states that a taxpayer’s method of accounting under the IITA is the same as the taxpayer’s method of accounting for federal income tax purposes. Finally, IITA Section 403 requires each taxpayer to take into account on his or her Illinois income tax return items of income, deduction and exclusion in the same manner as reflected on the taxpayer’s federal income tax return. Primarily as a result of these provisions, transactions that are deemed to occur for federal income tax purposes, and the tax consequences that result from those deemed transactions, likewise are deemed to occur and apply for purposes of the IITA. In addition, pursuant to IITA Sections 102 and 1501(a)(16), Department Regulations Section 100.9750(d)(1) provides that every entity treated as a partnership for federal income tax purposes shall be treated as a partnership under the IITA, and that no entity that is not treated as a partnership for federal income tax purposes will be treated as a partnership for purposes of the IITA.

Internal Revenue Code (IRC) Section 708(a)(1)(B) provides that a partnership shall be considered as terminated if within a 12-month period there is a sale or exchange of 50% or more of the total interest in partnership capital and profits. Treasury Regulations Section 1.708-1(b)(3) provides that for purposes of subchapter K and chapter 1 of the IRC, a partnership taxable year closes with respect to all partners on the date on which the partnership terminates. Treasury Regulations Section 1.708-1(b)(4) states that where a partnership terminates under IRC Section 708(a)(1)(B), the following is deemed to occur:

The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership; and, immediately thereafter, the terminated partnership distributes interests in the new partnership to the purchasing partner and the other remaining partners in proportion to their respective interests in the terminated partnership in liquidation of the terminated partnership, either for the continuation of the business by the new partnership or for its dissolution and winding up.

Under the provisions of the IITA discussed above, where a partnership terminates for federal income tax purposes, it likewise terminates for Illinois income tax purposes. Further, the transactions that are deemed to occur for federal purposes incident to a termination, and the tax consequences that result from those deemed transactions, are likewise deemed to occur and apply for Illinois income tax purposes. Accordingly, a partnership termination causes the partnership’s taxable year to end under the IITA, and the terminated partnership is deemed to transfer all of its assets and liabilities to a new partnership.

IITA Sections 203(d)(2)(D-6) and (P) require a partnership to make an addition and subtraction modification where property with respect to which bonus depreciation modifications have been required is sold, transferred, abandoned, or otherwise is disposed. Because a partnership terminated under IRC Section 708(a)(1)(B) is deemed to have contributed all of its assets to a new partnership, the addition and subtraction modifications under IITA Section 203(d)(2)(D-6) and (P) apply. For the taxable year of its termination, the partnership must add back the aggregate amount of subtraction modifications claimed on property under IITA Section 203(d)(2)(O), and may subtract the amount of the addition modification claimed on property under IITA Section 203(d)(2)(D-5).

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. If you have questions regarding this GIL you may contact Legal Services at (217) 782-7055. If you have further questions related to Illinois income tax laws, visit our website at [www.revenue.state.il.us](http://www.revenue.state.il.us) or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

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