IT 14-0006 GIL 07/28/14 Taxable Year
A corporation with two short federal taxable years within a calendar year must file two short-period Illinois income tax returns.

July 28, 2014

Re: Illinois income tax

Dear Xxxx:

This is in response to your letter dated June 18, 2014, in which you request a letter ruling regarding Illinois income tax law. 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 as follows:

> We recognized an Illinois NLD of $3,495,172 on our return rather than the limited NLD of $100,000.
>
> During the spring of XXXX, COMPANY A simultaneously pursued an initial public offering and also a private transaction. Ultimately, the shareholders elected the private transaction.
>
> As a result, our new majority shareholders had to create a new parent company, COMPANY B, which acquired all the shares of COMPANY A. and issued new shares of COMPANY B.
>
> Under the Federal IRS rules, we had to file a short year tax return for the period from January 1, XXXX through July 27, XXXX, because of the new parent company.
>
> If we had instead gone public, this new entity would not have been necessary. We would not have been required to file a short year return.
>
> Our XXXX full year Illinois taxable loss is demonstrated as follows:

	Fed taxable Income/loss	Illinois adj	Adj total income/loss	Illinois appt	Illinois income
1/1/XX-7/27/XX	(124,776,725)	5,582,300	(119,194,425)	.060533	(7,215,196)
7/28/XX-12/31/XX	47,729,343	11,589,298	59,318,641	.058923	3,495,172
Total XXXX	(77,047,382)	17,171,598	(59,875,784)		(3,720,024)

> Because of our split tax year, required by the Federal rules as described below, if we followed the $100,000 NLD limitation in our attached 12/31/20XX return, our XXXX full-year loss would be treated differently than other Illinois taxpayers who had the same total loss for the full year. Any other Illinois taxpayer with the same total full year loss would not pay any Illinois income tax for their tax year ended on December 31, 20XX.
>
> If we followed the form of the Illinois NLD limitation, our taxable income for the second short year would be $3,395,172, since we could only use $100,000 of the loss from the first short period.

Any other Illinois taxpayer which had the same net result for XXXX, but which did not have to file 2 short-year tax returns because there was not a new parent, would not have owed any income tax to Illinois for XXXX.

Form over substance would require that we would be allowed to recognize only $100,000 of our net operating loss in the second short period.

We believe this different outcome compared to all other Illinois taxpayers who had a December 31 year end and had losses in the first 7 months that were only partly offset by profits in the last 5 months, violates both the Equal Protection Clause of the US Constitution and the Equal Protection Clause of the Illinois Constitution.

The Equal Protection Clause of the US Constitution has been litigated in tax matters for many years.

Obviously, there are no cases that deal with this exact example.

However, an early case on a tax matter was ruled on by the US Supreme Court, *Hanover Fire Insurance Company v. Patrick J. Carr, County Treasurer of the County of Cook*, in which the Court reversed the Illinois Supreme Court. The Supreme Court's opinion made clear that it is the substance of a potential inconsistent tax result among taxpayers, not the form, which should be determinative.

In that case, the Court stated the following:

"But when the question is whether a tax imposed by a state deprives a party of rights secured by the Federal Constitution, the decision is not dependent upon the form in which the taxing scheme is cast, not upon the characterization of that scheme as adopted by the state court. We must regard the substance rather than the form, and the controlling test is to be found in the operation and effect of the law as applied and enforced by the state."

We believe that the substance of this situation is that it would be discriminatory to require us to pay tax on the earnings from our second short tax year of XXXX. Other Illinois taxpayers with the same total net loss over all of XXXX, who did not have to file 2 short year returns simply because of IRS regulations, would not be required to pay any Illinois tax. We believe our different outcome, if we filed this return according to the $100,000 NLD limit, would violate the Equal Protection Clause of both the US Constitution and the Illinois Constitution.

Therefore, we believe that our use of the $3,495,172 of our July period net operating loss as an NLD in our December Illinois tax return is appropriate.

RULING

Section 207 of the Illinois Income Tax Act (35 ILCS 5/207) allows the following deduction in the computation of Illinois net income:

(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;

…

(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, XXXX, and no carryover deduction shall exceed $100,000 for any taxable year ending on or after December 31, XXXX 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, or for which the deduction would exceed $100,000 if not for this subsection, shall be counted.

IITA Section 401(a) defines the "taxable year" of a taxpayer. In pertinent part, the section states:

(a) In general. For purposes of the tax imposed by this Act, the taxable year of a person shall be the same as the taxable year of such person for federal income tax purposes.

Your letter indicates that for federal income tax purposes COMPANY A had a short taxable year ending July 27, XXXX and a short taxable year ending December 31, XXXX. Under IITA Section 401(a), COMPANY A has taxable years ending July 27, XXXX and December 31, XXXX for Illinois income tax purposes. In addition, you indicate that for its taxable year ending July 27, XXXX, COMPANY A incurred an Illinois net operating loss of $7,215,196, while for its taxable year ending December 31, XXXX it generated Illinois net income of $3,495,172 (before taking into account any net operating loss deduction under IITA Section 207). Pursuant to IITA Section 207(d), the amount of net operating loss deduction that COMPANY A is allowed for its short taxable year ending December 31, XXXX may not exceed $100,000. Therefore, based on the facts you submitted, only $100,000 of the net operating loss carryover from the short taxable year ending July 27, XXXX may be used as a net operating loss deduction for taxable year ending December 31, XXXX. The remaining loss may be carried to future taxable years to the extent provided in IITA Section 207.

You argue that application of IITA Section 207(d) violates the Equal Protection Clause under United States Constitution and the Equal Protection Clause under the Illinois Constitution. However, the $100,000 loss limitation under IITA Section 207(d) applies uniformly to all corporations (other than subchapter S corporations). That Section 207(d) would not have applied at all had COMPANY A not engaged in certain transactions that caused it to have a short taxable year does not mean that it has been denied equal protection. Certainly, disparate tax results may result among taxpayers that enter into different transactions.

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)