IT 14-0008-GIL 08/19/14 SUBTRACTION MODIFICATIONS – OTHER RULINGS
In computing base income, only passive losses deducted in computing the individual taxpayer's federal adjusted gross income are allowable, and passive loss deductions of a nonresident must be sourced to Illinois according to the apportionment factors of the business that produces the losses. (This is a GIL.)

August 19, 2014

Re: Illinois income tax

Dear Xxxx:

This is in response to your letter dated March 17, 2014, received by our office July 16, 2014. 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:

> The primary purpose of this letter is to establish the Illinois nonresident filing requirements with regard to the use of prior year passive losses to offset current year passive income/gain.
>
> 1. Can passive losses in excess of passive income from Illinois source activities be carried forward to future tax years to offset passive income/gain?
>
> 2. If so, what method should be employed to allocate these losses if there are multiple IL source passive activities? For example, can/should the taxpayer employ the Federal methodology, according to federal form 8582, using only Illinois source activities?
>
> 3. If the passive losses can be used to fully offset passive income/gain, is a tax return required to be filed each year to preserve the losses, or is it sufficient to maintain records of the losses which would be available for future use?

RULING

Section 502(a) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/502(a)) sets forth the requirements for filing Illinois income tax returns. That section states in part as follows:

> (a) In general. A return with respect to the taxes imposed by this Act shall be made by every person for any taxable year:
>
> (1) For which such person is liable for a tax imposed by this Act, or
>
> (2) In the case of a resident or in the case of a corporation which is qualified to do business in this State, for which such person is required to make a federal income tax return, regardless of whether such person is liable for a tax imposed by this Act.

Under this section, a nonresident taxpayer must file an Illinois income tax return if the taxpayer incurs a liability for tax imposed under Section 201 of the IITA (or in the case of a corporation qualified to do business in Illinois, if it is required to file a federal return). A nonresident is generally liable for Illinois income tax under Section 201 if it computes "Illinois net income" as defined under IITA Section 202. IITA Section 202 defines Illinois net income as that portion of the taxpayer's "base income," as defined in Section 203, which is allocated or apportioned to Illinois under the provisions of Article 3 of the IITA, less certain deductions. The starting point in calculating base income under Section 203 is the taxpayer's taxable income (or adjusted gross income in the case of an individual) for federal income tax purposes. Taxable income (or adjusted gross income) is then modified by certain statutorily prescribed addition and subtraction modifications in order to arrive at base income. Under IITA Section 203(h), taxable income (adjusted gross income) is modified only as expressly provided in that section. The IITA contains no modifications with respect to deductions disallowed under the passive activity rules under IRC Section 469, nor does the IITA otherwise provide its own limitations on passive activity losses attributable to Illinois activities. Therefore, passive activity deductions are allowed for Illinois purposes to the extent allowed for federal income tax purposes. Passive activity deductions disallowed for federal income tax purposes are likewise disallowed for Illinois income tax purposes. See 86 Ill. Adm. Code §100.2410(a)(5). Passive activity losses allowed for federal income tax purposes are sourced according to the provisions of Article 3 of the IITA.

Under Article 3 of the IITA, nonbusiness income, together with any item of deduction directly allocable thereto, is allocated to Illinois under IITA Sections 301(c)(2) and 303. Business income is apportioned to Illinois under IITA Section 304. Under IITA Section 1501(a)(1), the term "business income" is defined as all income that may be treated as apportionable under the Constitution of the United States, net of deductions allocable thereto. IITA Section 1501(a)(13) defines nonbusiness income as all income other than business income or compensation income. IITA Section 304(a) provides for taxable years ending on or after December 31, 2000, that the apportionment factor for a nonresident deriving business income from Illinois and one or more other states (other than an insurance company, financial organization, or transportation company) shall be equal to its sales factor. Section 304(a)(3)(A) defines the sales factor as a fraction, the numerator of which is the total sales of the person in Illinois during the taxable year, and the denominator of which is the total sales of the person everywhere. IITA Section 1501(a)(21) defines the term "sales" to mean all gross receipts of the taxpayer that are part of the taxpayer's business income.

The following example illustrates the application of the above provisions.

Assume nonresident Taxpayer earned $20,000 of wage income for the taxable year, none of which is allocated to Illinois. In addition, taxpayer holds interests in passive activities A, B and C. The gross income and deductions from these activities is as follows:

	A	B	C	Total
Gross income	7,000	4,000	12,000	23,000
Deductions	(16,000)	(20,000)	(8,000)	(44,000)
Net income (loss)	(9,000)	(16,000)	4,000	(21,000)

Taxpayer's ($21,000) passive activity loss for the taxable year is disallowed under IRC Section 469. Taxpayer completes federal Form 8582 to determine that a ratable portion of the loss from activities A and B is disallowed. The disallowed portion of the loss from Activity A is $7,560. The disallowed portion of the loss from Activity B is $13,440.

Taxpayer's adjusted gross income is $20,000, comprised as follows:

Wage income	$20,000
Activity A	($1,440)
Activity B	($2,560)
Activity C	$4,000
Gross income	$20,000

Assume that Taxpayer has no addition or subtraction modifications, and that Activities A, B, and C are separate trades or businesses the income of which must be apportioned separately under 86 Ill. Adm. Code § 100.3010(b). Assume Activity A has an Illinois sales factor of 10%, Activity B has an Illinois sales factor of $20%, and Activity C has an Illinois sales factor of 50%. Taxpayer's Illinois net income is computed as follows (disregarding any net operation loss deduction or standard exemption):

	Base Income	Illinois net income
Wage income	$20,000	$0
Activity A	($1,440)	($144)
Activity B	($2,560)	($512)
Activity C	$4,000	$2,000
Illinois net income		$1,344

Note that the $7,560 disallowed loss from Activity A, and the $13,440 disallowed loss from Activity B, will be allocated to Illinois in the taxable year in which the losses are allowed for federal income tax purposes according to the sales factor (or other allocation method) applicable for that taxable year. See 86 Ill. Adm. Code § 100.2410(b)(1).

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 or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Brian L. Stocker
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