

**IT 02-19**

**Tax Type: Income Tax**

**Issue: Net Operating Loss (Individual)**

**STATE OF ILLINOIS  
DEPARTMENT OF REVENUE  
OFFICE OF ADMINISTRATIVE HEARINGS  
CHICAGO, ILLINOIS**

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<b>THE DEPARTMENT OF REVENUE</b>	)	
<b>OF THE STATE OF ILLINOIS</b>	)	<b>No. 01-IT-0000</b>
	)	
	)	<b>SSN 000-00-0000</b>
v.	)	
	)	<b>Tax Years: 1997 and 1998</b>
<b>JOHN DOE,</b>	)	
<b>TAXPAYER</b>	)	
	)	<b>Administrative Law Judge</b>
	)	<b>Kenneth J. Galvin</b>

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**RECOMMENDATION FOR DISPOSITION**

**Synopsis:**

On April 6, 2001, the Illinois Department of Revenue (hereinafter “the Department”) issued an Amended Income Tax Letter (“LTR-405”) to John Doe (hereinafter “taxpayer”). The basis of the LTR-405 was the Department’s determination that the taxpayer had reduced his federal adjusted gross income to negative numbers on amended Illinois income tax returns filed with the Department for 1997 and 1998. Taxpayer asked for a full refund for both years and the LTR-405 partially disallowed both refund claims.

On May 1, 2001, taxpayer filed a timely protest of the LTR-405 and requested a hearing. On October 17, 2001, the taxpayer and the Department agreed to submit the case solely by stipulation of fact and on December 6, 2001, the Department submitted a brief

on the issues involved. Taxpayer had an opportunity to submit, by January 11, 2002, a memorandum of law in support of his position pursuant to an Order entered in this cause on October 17, 2001. Taxpayer did not file any responsive memorandum. Following a review of the facts as stipulated and the relevant law, it is recommended that the Amended Income Tax Letter be finalized as issued.

**Findings of Fact:**

1. On April 6, 2001, the Department issued an Amended Income Tax Letter to the taxpayer partially denying his claims for refund for the overpayment of income taxes in years 1997 and 1998. Joint Stip. No. 2; Exhibit 1.
2. Taxpayer filed a timely protest, dated May 1, 2001, to the Amended Income Tax Letter. Joint Stip. No. 2; Exhibit 2.
3. Taxpayer filed his Form 1040, U.S. Individual Income Tax Return, for tax year ending December 31, 1999, showing an operating loss of (\$680,653). Joint Stip. No. 4; Exhibit 3.
4. On or about June 29, 2000, the taxpayer filed with the Internal Revenue Service (“IRS”) a Form 1045, “Application for Tentative Refund” in order to carry the operating loss from 1999 back to 1997 and 1998. The net operating loss (“NOL”), after adjustments which are not in dispute, was (\$702,841). Joint Stip. No. 5; Exhibit 5.
5. On or about September 22, 1998, taxpayer filed with the IRS a Form 1040, U.S. Individual Income Tax Return for 1997, showing an adjusted gross income (“AGI”) of \$394,345. Joint Stip. No. 6; Exhibit 6.

6. On or about September 22, 1998, taxpayer filed with the Department a Form IL-1040, Illinois Individual Income Tax Return for 1997, showing an AGI of \$394,345. Joint Stip. No. 7; Exhibit 7.
7. On or about September 22, 2000, taxpayer filed with the Department a Form IL-1040-X, Amended Income Tax Return for 1997, in which the previously filed AGI of \$394,345 was reduced to (\$308,496). Joint Stip. No. 8; Exhibit 8.
8. On or about October 15, 1999, taxpayer filed with the IRS a Form 1040, U.S. Individual Income Tax Return for 1998, showing an AGI of \$273,931. Joint Stip. No. 9; Exhibit 9.
9. On or about September 30, 1999, taxpayer filed with the Department a Form-IL-1040, Individual Income Tax Return for 1998 showing an AGI of \$273,931. Joint Stip. No. 10; Exhibit 10.
10. On or about September 22, 2000, taxpayer filed with the Department a Form IL-1040-X, Amended Income Tax Return for 1998, in which the previously filed AGI of \$273,931 was reduced to (\$282,220). Joint Stip. No. 11; Exhibit 11.

**Conclusions of Law:**

The Internal Revenue Code (“IRC”) permits individual taxpayers to carry a net operating loss back to the second and first preceding tax years and then forward. IRC Sec. 172(b)(1)(A). The NOL consists of the taxpayer’s AGI in the loss year adjusted by deducting non-business deductions (but only to the extent of non-business income) and no deduction is allowed for exemptions. IRC Sec. 172(c)(d). In the instant case, the taxpayer’s AGI in the loss year of 1999 was (\$680,653). This AGI was adjusted by the taxpayer resulting in a NOL of (\$702,841). The adjustments are not in dispute. Taxpayer

then filed a Form 1045, "Application For Tentative Refund" with the IRS applying the (\$702,841) against the 1997 AGI of \$394,345 and 1998 AGI of \$273,931.

The Illinois Income Tax Act, 35 ILCS 5/101 *et seq.* ("IITA") provides that an individual's base income is equal to his AGI subject to certain modifications. 35 ILCS 5/203. The IITA does not provide for any Illinois NOL deductions. Instead, the IITA relies on the federal NOL deduction allowed in computing federal AGI which is the starting point for determining an individual's Illinois base income. The Department has taken the position that federal AGI reportable on line 1 of an individual's Illinois 1040 cannot be less than zero. This is to prevent the double benefit that would occur if an individual carried back a current NOL federally, thereby reducing the amount reported as AGI for the carry back year and thereby also reducing the amount calculated as Illinois base income for the carry back year, while at the same time reporting the same loss as current negative AGI on the Illinois individual income tax return for the loss year. Letter Ruling No. 82-0446, April 2, 1982, 1982 WL 16505.

Taxpayer's Form 1045 (Exhibit 5) was the basis for his IL-1040-X returns for 1997 and 1998 (Exhibits 8 and 11). On line 1 of taxpayer's IL-1040-X for 1997, taxpayer reduced his prior AGI of \$394,345 (Column A) to a negative amount of (\$308,496) (Column B). On taxpayer's IL-1040-X for 1998, he reduced his prior AGI of \$273,931 (Column A) to a negative amount of (\$282,220) (Column B). Taxpayer then calculated his Illinois tax for 1997 and 1998, based on the negative amounts, and arrived at a zero tax. In effect, taxpayer applied the NOL of (\$702,841) against the 1997 and 1998 AGI's reducing them to negative numbers.

However, in any given tax year, the NOL can only be consumed to the extent of modified taxable income with the excess applied to the next succeeding year: “You must make certain modifications to your taxable income to determine how much NOL you will use up on that year and how much you can carry over to the next tax year. Your carryover is the excess of your NOL deduction over your modified taxable income for the carry-back or carry-forward year.” “Your taxable income as modified cannot be less than zero.” Publication 536, “Net Operating Losses (NOL’s) for Individuals, Estates, and Trusts,” p. 11. On taxpayer’s Form 1045, Schedule B, he determined his “modified taxable income” on line 8 as \$146,690 for 1997 and \$93,054 for 1998. Although taxpayer had a NOL of (\$702,841) available, it could only be consumed to the extent of his “modified taxable income” in 1997 and 1998, with the remainder carried forward.

Accordingly, taxpayer’s Form 1045, “After Carry-back” column should have been completed as follows: 1997 (former) AGI of \$394,345 less net operating loss deduction available of \$146,690 equals (new) AGI of \$247,655; 1998 (former) AGI of \$273,931 less net operating loss available of \$93,054 equals (new) AGI of \$180,877. The (new) AGI figures, above, were used in calculating the taxpayer’s Illinois refunds for 1997 and 1998 in the Department’s Amended Income Tax Letter.

WHEREFORE, for the reasons stated above, it is recommended that the Amended Income Tax Letter be finalized as issued.

ENTER:

February 5, 2002

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Kenneth J. Galvin  
Administrative Law Judge