

General Information Letter: No subtraction modification is allowed for depreciation of property received in a like-kind exchange based on the excess of fair market value of the property over its federal income tax basis.

April 9, 2009

Dear:

This is in response to your letter dated March 6, 2009 in which you state the following:

1. It is obvious that not every situation can be covered by instructions. We have such a situation.
2. In brief, COMPANY1's predecessor i.e. COMPANY2 was involved in a Section 1031 exchange i.e. a warehouse in STATE1 was exchanged for warehouses in Illinois and STATE2. We have had no problems with STATE2 to date; only with Illinois.
3. Since gain was deferred for federal tax purposes, the basis is accordingly reduced. This makes for lower foreign depreciation, versus Illinois depreciation – see 4 below.
4. The basis for Illinois is the full cost of the replacement property in Illinois i.e. not reduced by deferred gain. Hence depreciation is higher for Illinois purposes than for federal purposes – see 3 above.
- 5A. COMPANY1 accordingly added back the lower federal depreciation on Line 7 of 2007 Schedule M, making reference to Schedule 1.
- 5B. COMPANY1 also deducted the higher Illinois depreciation on Line 23 of 2007 schedule M, making reference to Schedule 1.
- 5C. COMPNY1 attached Schedule 1 to explain the depreciation adjustments, in more detail.
- 5D. A copy of 2007 Schedule M and Schedule 1 is attached.
6. Since this matter will keep coming up and cause unnecessary correspondence and delays in processing, I request a decision whether COMPANY1 is handling the matter properly or not. If not, a detailed explanation would be helpful.

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill. Adm. Code §1200, or on the website <http://www.tax.illinois.gov/LegalInformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

Section 203(d)(1) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.) states that a partnership's base income is the amount equal to its taxable income as properly computed for federal income tax purposes modified by various addition and subtraction modifications found in IITA Section

203(d)(2). Pursuant to IITA Section 203(h), no addition or subtraction modifications are allowed unless specifically provided for in IITA Section 203(d)(2):

**203(h): Legislative intention.** Except as expressly provided by this Section there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise.

Your letter indicates that COMPANY1, LLC (hereinafter "COMPANY1") received an Error Notice Response as a result of disallowed federal and Illinois depreciation adjustments on Schedule M involving an IRC Section 1031 Exchange. Attached to your letter and in support of the Schedule M adjustments is a Schedule 1 that states "a modification for the depreciation difference is required to arrive at the proper net income (loss) from *rental* of real property" (emphasis added). The benefit of IRC Section 1031 exchanges is the ability to replace like-kind property without having to pay taxes on the transaction until the taxpayer sells the newly acquired property. The supporting documentation indicates that COMPANY1 has not sold the property, but is renting the property. The gain from the exchange is excluded for federal purposes until the property is sold, and such gain is likewise excluded for Illinois purposes as there is no provision adding the gain back into the computation of base income. Because there are no modifications expressly allowed in IITA Section 203(d) for the addition and subtraction amounts shown on your Schedule M, COMPANY1 is not entitled to Schedule M adjustments. The Error Notice Response is correct.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott  
Staff Attorney -- Income Tax