

General Information Letter: Trust created and funded by another trust, which had incurred Illinois net losses in prior years, is not entitled to deductions for the carryforward of the losses of that other trust.

August 21, 2009

Dear:

This is in response to your letter dated July 14, 2009 in which you request information regarding the above named taxpayer. The nature of your request and the information you have 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 at [www.revenue.state.il.us](http://www.revenue.state.il.us).

In your letter you have stated the following:

We are in receipt of the Department's notice dated June 22, 2009 regarding the disallowance of the net operating loss carryforward claimed on the 2006 tax return for the above mentioned taxpayer.

We respectfully request that the tax assessment be reviewed based upon the facts presented in this letter. TRUST1 (EIN XX-XXXXXXX) was funded in 2005 using a portion of the assets from the TRUST2 (EIN XX-XXXXXXX). The remaining assets of the TRUST2 consisted of securities and investments that were used to fund the TRUST3 and TRUST4. A final return for the TRUST2 was filed in 2005. One of the assets used to fund the new TRUST1 was a wholly owned interest in, thereby including all the assets of, COMPANY, LLC (EIN XX-XXXXXXX), a single member LLC which operates grain facilities in northern Illinois. At the time of funding, COMPANY, LLC had an accumulated net operating loss carryover of \$324,444. This loss had been reported on Schedule NLD for the TRUST2 Irrevocable Trust. When the assets were transferred to the TRUST1, the loss carryforward attribute was transferred with the entity to which it was attached (COMPANY, LLC). Thus the loss was reported on the 2006 Illinois Schedule NLD for the acquiring trust (TRUST1). The nature and extent of the operations of COMPANY, LLC did not change after acquisition of the entity by the new trust.

While there appears to be limited authoritative guidance on the treatment of net operating loss carryforwards within trusts, such as the one described above, we believe we can rely on Illinois Regulation 100.4500 to provide some guidance. Per 86 Ill. Adm. Code 100.4500(a), except as provided by statute, carryovers of net loss deductions are only allowed to be claimed by the taxpayer that incurred the loss. In addition, section 100.4500(a)(3) also notes that net loss deductions incurred and credits earned by one entity may be carried back or forward for use only by that same entity and cannot be used by a different entity. Using these regulations, the loss generated by COMPANY, LLC must stay with COMPANY, LLC as it is a separate legal entity, and can only be used to offset future income of COMPANY, LLC. The 2006 federal tax return indicates that the TRUST1 included income of \$490,525 from COMPANY, LLC. Thus, there was sufficient income from the LLC to absorb its existing loss carryforward.

In essence, the assets of the former Irrevocable Trust were acquired by the new TRUST1 Irrevocable Trust. Per 86 Ill. Adm. Code 100.400(b), when a corporation acquires the assets of another corporation, the acquiring corporation shall succeed to and take into account all credits and net losses from which the assets were acquired. While this authoritative reference is not

specific to trusts, the transaction that actually occurred seems to be reflective and in the spirit of the reference (one trust acquired assets from the other). Similar treatment is referenced related to acquisitions of between partnerships as described in 86 Ill. Adm. Code 100.4500(c), insomuch as to state that in the case of the acquisition of assets of a partnership by another partnership in a transaction in which the acquiring partnership is considered to be a continuation of the partnership from which the assets were acquired, the acquiring partnership shall succeed to and take into account, all credits and net losses of the partnership from which the assets were acquired. Based on this scenario as well, it would seem as though an acquiring trust would have the rights to the carryovers associated with the assets acquired. In this case, COMPANY, LLC would have come into the acquiring trust with the loss carryforward attached to it.

Please further review this assessment based on the information provided. We respectfully request that all tax, interest, and penalties assessed be abated, as the taxpayer has a right to claim the loss carryforward based on two underlying arguments:

1). COMPANY, LLC was the entity that incurred the loss and thus, it is the only entity that may claim the carryover. While the LLC's income is reported on the return for TRUST1, it remains a separate legal entity carrying its own tax attributes. There is sufficient income from the LLC in the 2006 tax year to absorb the loss carryover. Other trust income was not offset with the loss.

2). The assets of COMPANY, LLC were transferred to/acquired by another trust in late 2005. In the spirit of the rules for acquisitions of corporations and partnerships, as specified in the Illinois Administrative Code, the acquiring entity also acquires carryover credits and net operating loss carryforwards of the assets acquired. In this case, a newly funded trust acquired the assets of an existing trust. Thus, the loss associated with the assets acquired remained with those respective assets.

## **RULING**

Section 405(a) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/405(a)) states:

In the case of the acquisition of assets of a corporation by another corporation described in Section 318(a) of the Internal Revenue Code, the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, all Article 2 credits and net losses under Section 207 of the corporation from which the assets were acquired.

Section 405(b) of the IITA states:

In the case of the acquisition of assets of a partnership in a transaction in which the acquiring partnership is considered to be a continuation of the partnership from which the assets were acquired under the provisions of Section 708 of the Internal Revenue Code and any regulations promulgated under that Section, the acquiring partnership shall succeed to and take into account, as of the close of the day of distribution or transfer, all Article 2 credits and net losses under Section 207 of the partnership from which the assets were acquired.

Interpreting IITA Section 405, Department Regulations Section 100.4500(a) states in part:

- a) In general. Except as expressly provided by statute, carryovers of net loss deductions and credits are only allowed to be claimed by the taxpayer that incurred the loss or earned the credit. See, e.g., *New Colonial Ice Co. v. Helvering*, 292 U.S. 435 (1934).
  - 1) ...
  - 2) One exception to this general rule occurs in cases where, as the result of a statutory merger, a corporation is treated as the same taxable entity as the corporations merged into it. Even then, carryovers are allowed only to the extent there is a continuity of business enterprise between the pre- and post-merger entities. See *Libson Shops, Inc. v. Koehler*, 354 U.S. 382 (1957); *Newmarket Manufacturing Co. v. U.S.*, 233 F.2d 493 (1<sup>st</sup> Cir. 1956).
  - 3) In other situations that are not covered by an express provision of the IITA, net loss deductions incurred and credits earned by one entity may be carried back or forward for use only by that same entity, and cannot be used by a different entity.

The general rule stated in Regulations Section 100.4500(a) applies in this case. Although your letter does not explicitly state, it appears that COMPANY, LLC, a single member LLC, is a disregarded entity for federal income tax purposes. For example, you indicate that on its 2006 federal income tax return the TRUST1 included income of \$490,525 from COMPANY LLC. Under Treasury Regulation § 301.7701-2(b), if an entity is disregarded for income tax purposes, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner. The same treatment applies for Illinois income tax purposes. See Department of Revenue Regulations Section 100.9750. As a disregarded entity, all the items of income and loss of COMPANY, LLC prior to 2006 were treated as the income and loss items of the TRUST2, and COMPANY, LLC would not as a separate entity derive any tax attributes. If the business operations of COMPANY, LLC caused the TRUST2 to incur Illinois net operating loss carryovers, the carryovers belong to the TRUST2 and may not be used by another taxpayer except as provided in IITA Section 405 and Department Regulations Section 100.4500(a). In this case, the acquisition by the TRUST1 of the membership interest in COMPANY, LLC is not an acquisition described in IITA Section 405(a) or Section 405(b), nor is it a transaction described in Department Regulations Section 100.4500(a)(2). Therefore, the Illinois net loss carryovers incurred by the TRUST2 cannot be used the TRUST1.

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 further questions regarding this GIL, please call (217) 782-7055. If you have additional questions regarding Illinois income tax laws, please visit the Department's web site at [www.ILtax.com](http://www.ILtax.com).

Sincerely,

Brian L. Stocker  
Associate Counsel (Income Tax)