

General Information Letter: A trust may not succeed to an Illinois net loss carryover of another trust.

October 19, 2009

Dear:

This is in response to your letter dated September 21, 2009 in which you request information regarding the Illinois income tax. 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.

In your letter you have stated the following:

We are in receipt of your response to our request dated August 21, 2009. However, we believe that additional information may result in a more favorable outcome for the taxpayer.

You reference in your discussion Treasury Regulation §301.7701-2(b): Per this regulation, because the entity is a single member LLC its attributes are treated as they belong to the owner, in this case TRUST1. We agree with this analysis. However, the distribution of the losses upon termination of the predecessor trust remains at issue. Internal Revenue Code Section 642(h) addressed the use of unused loss carryovers. The section specifically states:

If on the termination of an estate or trust, the estate or trust has –

- (1) a net operating loss carryover under section 172 or a capital loss carryover under section 1212, or
- (2) for the last taxable year of the estate or trust deductions (other than the deductions allowed under subsections (b) or (c)) in excess of gross income for such year,

that such carryover or such excess shall be allowed as a deduction, in accordance with regulations prescribed by the Secretary to the beneficiaries succeeding to the property of the estate or trust.

As such, upon termination of the TRUST1 at the conclusion of the 2005 tax year, the loss carryovers are to be and were reported on the K-1s of the beneficiaries as excess carryovers (Code D and E in Box 11). The TRUST1 had three beneficiaries – TRUST2, TRUST3, and TRUST4. The TRUST2 and TRUST3 Trusts received securities and investments. The capital loss carryovers associated with these securities were distributed to the two trusts on the final K-1, as the TRUST2 and TRUST3 trusts were the “beneficiaries succeeding to the property of the estate or trust.” The 100% interest in COMPANY, LLC, which would have been property of the trust, had a single beneficiary as well – the TRUST4. The losses associated with this property were allocated to the appropriate beneficiary.

Using the State’s argument it seems as though these losses would have died upon termination of the TRUST1. We do not believe that this is a fair assessment and it does not correspond to federal treatment. Under federal treatment, and as accepted by the IRS on the 2005 tax return, the tax attributes carry with the property received by the beneficiary. In this case the asset received by the TRUST1 is COMPANY, LLC and its related net operating loss carryover.

In addition, we believe there is further argument within Section 405(a) and (b) of the Illinois Administrative Code. While these sections specifically relate to transactions of an acquiring partnership or an acquiring corporation, the Illinois Code does not have a specific corresponding reference for transactions between trusts, when the acquiring trust is deemed to be a continuation of the existing business. Thus the Sections referenced reflect the spirit of the transaction as it relates to similar facts and circumstances of other entity types. It also corresponds to the federal treatment presented above.

RULING

As indicated in the Department's previous GIL regarding this taxpayer, the general rule stated in Regulations Section 100.4500(a) (86 Ill. Adm. Code 100.4500(a)) applies in this case. The acquisition by the TRUST4 of the membership interest in COMPANY, LLC is not an acquisition described in Illinois Income Tax Act Section 405(a) ("IITA" ; 35 ILCS 5/405(a)) or Section 405(b) (35 ILCS 5/405(b)), nor is it a transaction described in Department Regulations Section 100.4500(a)(2) (86 Ill. Adm. Code 100.4500(a)(2)). Therefore, the Illinois net loss carryovers incurred by the TRUST1 cannot be used the TRUST4.

Where the IITA intends to incorporate provisions of the Internal Revenue Code or other federal tax rules, there is specific provision in the statute to effect that incorporation. See, for example, IITA Sections 102, 201, 203(e), 204, 205, 210, 212, 402, 405, 501, 502, 1005, 1008, 1405.1, and 1501. There is no provision in the IITA that either incorporates IRC Section 642(h) or provides a similar rule in the case of Illinois net operating loss carryovers upon termination of a trust. Therefore, no such rule applies. There is no generally applicable rule that Illinois income tax law must follow federal income tax law. Federal rules do not apply for Illinois income tax purposes unless the IITA applies them.

In addition, that IITA Section 405 provides for the transfer of Illinois net operating loss carryovers in the case of certain corporate and partnership acquisitions, but does not provide a similar transfer upon termination of a trust, is not authority for the proposition that Illinois net operating loss carryovers transfer under Section 405 from trust to beneficiaries. It is authority for the proposition that they do not transfer.

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.

Sincerely,

Brian L. Stocker
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