ILLINOIS INDEPENDENT
TAX TRIBUNAL

JEFFERY A. PRITKIN and BENJAMIN D. HOLLAND, not individually but as Co-Trustees of the ISADORE M. BERNSTEIN TRUST, Petitioner,	)	
v.	)	16 TT 59 Judge Brian F. Barov
ILLINOIS DEPARTMENT OF REVENUE, Respondent.	)	

ORDER ON SUMMARY JUDGMENT MOTION

The Petitioner, JEFFERY A. PRITKIN and BENJAMIN D. HOLLAND, not individually but as Co-Trustees of the ISADORE M. BERNSTEIN TRUST ("the "Trust"), filed a petition challenging a Notice of Deficiency issued by the Illinois Department of Revenue ("Department") assessing the Trust additional tax, interest and penalty for the 2014 calendar-year ending tax period. The deficiency arose because the Department disallowed the Trust a carryforward of a federal net operating loss deduction on the Trust's Illinois income tax return. The Trust has filed a motion for summary judgment arguing that the Illinois Income Tax Act ("IITA") allows the net operating loss carryforward, but the Department disagrees. As explained below, the Department is correct that the IITA does not allow the net loss carryforward deduction the Trust claims, and the Trust is not entitled to summary judgment.

Background

On March 18, 2010, Isadore M. Bernstein died. He left assets probated in Cook County Illinois under both an estate and under the Trust. Section 645 of the Internal Revenue Code ("IRC"), 26 U.S.C. § 645, permits a trust to elect to be treated and taxed for income tax purposes as part of its related estate for a set time-period. The Trust and estate exercised this election and were treated by the Internal Revenue Service and the Department as a combined entity for an election period that expired with the tax year ending November 30, 2012.

The combined entity filed both federal and Illinois income tax returns for its existing years. For the tax year beginning on December 1, 2010 and ending November 30, 2011, the combined entity filed its federal and state tax returns under FEIN No. 27-XXXXXXX. The combined entity reported a taxable loss on its federal form 1041, *see* Pet'r Mot. for Summ. J., Ex. A, which resulted in an operating loss of $537,442 on its Illinois 1041 form, *see id.* Ex B. For the tax period ending on November 30, 2012, the combined entity reported an additional net operating loss of $792,735 on its Illinois 1041 form. Dep't Resp. to Mot. for Summ. J., Ex. 3.

After the election period ended, the Trust became the successor entity to the combined entity under U.S. Treasury Regulation § 1.645(1)(h), 26 C.F.R. § 1.645-1(h), but the Trust and estate filed separate Illinois income tax returns. The Trust became a calendar year taxpayer, while the estate's tax period continued to end on November 30th. Thus, for the tax year ending on November 30, 2013, the estate filed a separate IL-1041 form, under the combined entity's FEIN No. 27-XXXXXXX, and declared a loss of $75,862. This loss, per the Department, increased the aggregate net loss carryforward associated with FEIN No. 27-XXXXXXX to $1,406,039. Dep't Resp. to Mot. for Summ. J. at 2. For the tax year ending on November 30, 2014, the estate filed an IL-1041, reporting income of $7099 reducing the available aggregate net loss carryforward associated with under FEIN No. 27-XXXXXXX in the same amount. *Id.*

The Trust, now a calendar year filer, filed separate federal and Illinois tax returns for the one month ending December 31, 2012, under a new FEIN No. 27-YYYYYYY. On the Illinois 2012 year-end return, the Trust reported a loss of $85,722, but also attached a 2012 Schedule NLD to this return reporting the combined entity's net operating losses for the 2011 tax-year of $537,422 and 2012 tax-year of $792,735. *Id.*

For the next tax year, ending on December 31, 2013, the Trust again filed under FEIN No. 27-YYYYYYY. For that period, it reported income of $12,477 on its IL-1041, and it claimed a net operating loss carryforward deduction in this amount. The Department allowed this carryforward deduction because it was less than the taxable income $85,722 reported on the Trust's 2012 calendar-year return. The Department reduced the Trust's available net operating loss carryforward to $73,245, in its records. *Id.*

For the tax year ending December 31, 2014, the tax year in dispute, the Trust again filed an IL-1041 under FEIN No. 27-YYYYYYY. The Trust reported federal taxable income of $125,869 on Line 1 of its IL-1041. Pet'r Mot. for Summ. J., Ex. D. On Line 2 it added back its federal net operating loss deduction of $282,987, realized that year, as required by section 203(c)(2)(D) of the IITA, 35 ILCS 5/203(c)(2)(D).[1] On Line 30, the Trust claimed an Illinois net loss deduction of $408,956 that was carried forward from the combined entity's November 30, 2011 tax year, which purportedly eliminated its Illinois tax liability. *See* Pet'r Mot. for Summ. J., Ex. A, 2014 Schedule NLD.

The Department disallowed this net loss deduction and issued a Notice of Deficiency assessing the Trust additional income tax, interest and penalties for the 2014 tax year. During the summary judgment proceedings, the Department has acknowledged that the Trust had a $73,245 net loss carryforward available to it for its 2014 tax year IL-1041 return, and has requested that the matter be remanded to

[1] Article 2 of the IITA was recently amended with the enactment of Public Act 100-22. *See* Ill. Legis. Serv. P.A. 100-22 (S.B. 9) (West). The amendatory language is not relevant to this case.

the Department to recalculate the Trust's tax liability based on recognizing this loss.

Analysis

The parties agree on the filing history set forth above and on the basic contours of federal tax law that underlie the dispute in this case. Section 645 of the Internal Revenue Code ("IRC"), 26 U.S.C. § 645, permits a trust to elect to be treated and taxed for income tax purposes as part of its related estate for a time-period after the decedent's death. Under the Internal Revenue Service's regulations, once the election period expires, all items of income are treated as being distributed to the new trust. Treas. Reg. 1.645-1(h), 26 C.F.R. § 1.645-1(h).

Further, section 172 of the IRC established a net operating loss deduction, which a taxpayer may carry forward to taxable years after the year of loss. *See* 26 U.S.C. § 172. Section 642(h) of the IRC provides that when a trust terminates, the beneficiaries succeeding to the property of the trust can take advantage of section 172's net operating loss carryforward deduction. *See* 26 U.S.C. § 642(h). The Trust claims, and the Department does not dispute, that under the IRC and its regulations, the Trust "became the beneficiary" of the terminating combined entity and can claim its carryforward deduction. *See* Pet'r Mot. for Summ. J. at 5; Dep't Resp. to Mot. for Sum. Judgment at 6.

The parties disagree on whether the Trust has a similar status under the IITA and can thus carry forward the net operating loss deductions reported by the combined entity during the election period to the Trust's Illinois 2014 year-end tax period. Whether the Trust can claim the combined entity's net operating loss carryforward requires a construction of the IITA, and is a matter properly determined on summary judgment. *See 1010 Lake Shore Ass'n v. Deutsche Bank Nat'l Trust Co.,* 2015 IL 118372 (2015), ¶ 20. The rules of statutory construction are well-known; the "primary goal . . . is to ascertain and effectuate the legislature's intent." *Estate of Alford v. Shelton*, 2017 IL 121199, ¶ 36. "The best indicator of legislative intent is the statutory language itself, given its plain and ordinary meaning." *Id.* Statutory language, however, should be construed in its entirety "bearing in mind the subject it addresses and the legislature's apparent intent in enacting it." *Id.*

In addition to the general rules of statutory construction, "(t)he granting of a deduction for net operating losses is a privilege created by statute as a matter of legislative grace." *Bodine Elec. Co. v. Allphin*, 81 Ill. 2d 502, 512-13 (1980) (internal quotation marks and citations omitted). Thus, "the taxpayer is not entitled to [such] a deduction unless clearly allowed by statute and the burden is on the taxpayer to show he is entitled to the deduction claimed." *Id.* at 513; *Rockwood Holding Co. v. Dep't of Revenue*, 312 Ill. App. 3d 1120, 1126 (1st Dist. 2000).

The IITA imposes a tax on the Trust's "net income." 35 ILCS 5/201. Net income is defined, for our purposes, as the Trust's "base income for such year . . . less . . . the deduction allowed by Section 207." 35 ILCS 5/202. Base income is the Trust's federal "taxable income for the taxable year as modified by paragraph (2)." 35 ILCS 5/203(c)(1). In this way, the IITA "piggy-backs" onto the federal calculation of income, and uses federal taxable income as the premise for Illinois tax liability. *Rockwood Holding Co.*, 312 Ill. App. 3d at 1124 (internal quotation marks omitted).

Although the IITA relies on the federal calculation of taxable income as its starting pointing, it has not adopted substantive provisions of the IRC, nor does it create "a parallel set" of Illinois deductions. *Bodine Elec. Co.*, 81 Ill. 2d at 509-510. In *Bodine Electric Company*, the Illinois Supreme Court thus refused to recognize an Illinois net loss deduction before it was included in the IITA. *Id.* at 509-13. Likewise, in *Rockwood Holding Company*, the appellate court held that a taxpayer was not entitled to carry forward a net operating loss where IITA did not provide for it for the tax year in question. *See* 312 Ill. App. 3d at 1126-27.

For the Trust to carry forward the combined entity's 2011 net loss deduction to the 2014 tax year it is not enough that it is permitted to do so under federal law, there must some clear authority found in the IITA supporting the deduction. *Bodine Elec. Co.*, 81 Ill. 2d at 509-510.[2] The Trust looks to sections 203(c) and 207

---

[2] The Department asserts that "[w]here the IITA intends to incorporate provisions of the Internal Revenue Code or other or other federal tax rules, there is specific provision in the statute to effect

of the IITA to support its claim. Department replies that section 405 forecloses the Trust's claim for the net loss carryforward deduction.

First, section 203 of the IITA defines the base income of trusts as "an amount equal to the taxpayer's [federal] taxable income, for the taxable year as modified by subsection (2)." 35 ILCS 35/203(c)(1). The Trust relies on 35 ILCS 5/203(c)(2)(E) to support its case. Although it is not necessary to parse this provision in detail, it is set out in full:

> (E) For taxable years in which a net operating loss carryback or carryforward from a taxable year ending prior to December 31, 1986 is an element of taxable income under paragraph (1) of subsection (e) or subparagraph (E) of paragraph (2) of subsection (e), the amount by which addition modifications other than those provided by this subparagraph (E) exceeded subtraction modifications in such taxable year, with the following limitations applied in the order that they are listed:
> (i) the addition modification relating to the net operating loss carried back or forward to the taxable year from any taxable year ending prior to December 31, 1986 shall be reduced by the amount of addition modification under this subparagraph (E) which related to that net operating loss and which was taken into account in calculating the base income of an earlier taxable year, and
> (ii) the addition modification relating to the net operating loss carried back or forward to the taxable year from any taxable year ending prior to December 31, 1986 shall not exceed the amount of such carryback or carryforward;
> For taxable years in which there is a net operating loss carryback or carryforward from more than one other taxable year ending prior to December 31, 1986, the addition modification provided in this subparagraph (E) shall be the sum of the amounts computed independently under the preceding provisions of this subparagraph (E) for each such taxable year;

---

that incorporation." *See* Supp. Br. at 4 (citing Ill. Dep't of Revenue, IT 09-0038-GIL (October 19, 2009)). This is a bit of an overgeneralization. *See, e.g.*, *Am. States Inc. Co. v. Hamer*, 352 Ill. App. 3d 521, 531 (1st Dist. 2004) (noting that the Department accepted the IRC's section 338(h)(10) deemed asset acquisition fiction as a matter of policy). In any event, the supreme court's articulated standard for tax deductions is "clearly allowed," *Bodine*, 81 Ill. 2d at 513, not specifically incorporated, and "clearly allowed" is the standard that will be applied here.

35 ILCS 5/203(c)(2)(E).

This provision does not apply here for the obvious reason that it applies to net operating loss carryforwards arising out tax years ending before December 31, 1986. The net operating loss carryforwards disputed here arose out of tax year ending November 30, 2010, and thus section 203(c)(2)(E) is inapplicable.

Section 203(c)(2)(D), however, applies to the tax periods in question when calculating base income, and it states:

> (1) In general. In the case of a trust or estate, base income means an amount equal to the taxpayer's taxable income for the taxable year as modified by paragraph (2).
>
> * * *
>
> (2) Modifications. Subject to the provisions of paragraph (3), the taxable income referred to in paragraph (1) shall be modified by adding thereto the sum of the following amounts:
>
> ***
>
> ((D) The amount of any net operating loss deduction taken in arriving at taxable income, other than a net operating loss carried forward from a taxable year ending prior to December 31, 1986;

The Trust complied with this provision on its 2014 year-end return. The first step in calculating the Trust's Illinois income is its federal taxable income, which it reported as $125,869 on Line 1 of its IL-1041. Pet'r Mot. for Summ. J., Ex. D. The next step under section 203(c)(2)(D) is to add back "any net operating loss deduction taken in arriving" at its Line 1 taxable income, which the Trust reported as $282,987 for the 2014 tax year on Line 2. *Id.*, Ex. A. But section 203(c)(2)(D) does not address carrying forward net operating losses from prior tax years, which the Trust sought to do in carrying forward the $408,956 from the combined entity's earlier tax year on Line 22. Rather, as noted above, the application of the net operating loss carryforward deduction is a function of section 207.

Section 207(a) provides three options, "[i]f after applying all of the (i) modifications provided for in . . . paragraph (2) of Section 203(c) . . . the taxpayer's net income results in a loss. 35 ILCS 5/207(a)." First,

> (1) for any taxable year ending prior to December 31, 1999, such loss shall be allowed as a carryover or carryback deduction in the manner allowed under Section 172 of the Internal Revenue Code;

Subsection (a)(1) as least suggests that for tax years ending before December 31, 1999, the legislature intended to tie the Illinois and federal net operating loss deductions together to some degree. *See Rockwood Holdings*, *Inc.*, 312 Ill. App. 3d at 1127 (noting that with its 1985 enactment, section 207 "now aligns itself with the IRC"). Thus, if the tax period involved here ended prior to December 31, 1999, the Trust would have an argument that it could take advantage of the combined entity's net loss carryforward deduction. But of course, section 207(a)(1) does not apply to the 2014 year-end tax period in issue.

Moreover, the phrase "in the manner allowed under Section 172 of the Internal Revenue Code" was omitted from subsections (2) and (3) of section 207, which state:

> (2) for any taxable year ending on or after December 31, 1999 and prior to December 31, 2003, such loss shall be allowed as a carryback to each of the 2 taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 20 taxable years following the taxable year of such loss; and
>
> (3) for any taxable year ending on or after December 31, 2003, such loss shall be allowed as a net operating loss carryover to each of the 12 taxable years following the taxable year of such loss, except as provided in subsection (d).

35 ILCS 5/207(a)(2)-(a)(3). The elimination of any reference to IRC 172, in subsections 207(a)(2) and (a)(3) indicates that after 1999, the legislature intended to decouple the IITA from IRC. *See Estate of Alford*, 2017 IL 121199, at ¶ 45 (use of one term in one part of a statute and a differing term in another indicates different

meanings were intended); *Julie Q. v. Dep't of Children & Family Serv.*, 2013 IL 113783, ¶ 41 ("The legislature's decision to use certain language in one instance and different language in another indicates that the legislature intended different results."). Further, the legislative debate on the bill that became subsection 207(a)(3) also indicates a general intent to limit or end section 207's tax benefits. *See* 93rd Gen. Assem., House Proceedings, May 30, 2003, at 228 (remarks of Rep. Currie) (explaining S.B. 1634) (Public Act 93-0029) (codified at 35 ILCS 207(a)(3)).

Given the apparent legislative intent to decouple the IITA from federal law regarding net operating loss deductions, I cannot ignore Department regulation 86 Ill. Adm. Code 100.9750(a), which, while not cited by the Department, states:

> e) Trusts. The term "trust" is not defined in the IITA. However, pursuant to IITA Section 102, any entity treated as a trust for federal income tax purposes under 26 CFR 301.7701-4 is a trust for all purposes of the IITA. *An entity that has elected to be treated as part of an estate under 26 USC 645 is not a trust, but is part of the estate for all purposes of the IITA.* Similarly, a trust whose assets, activities and income are treated as belonging to its grantor for federal income tax purposes under the "grantor trust" provisions of 26 USC 671 is not treated as a trust for Illinois income tax purposes.

Id. (Source: Amended at 34 Ill. Reg. 12891, effective August 19, 2010) (emphasis added). This regulatory language, under which the Trust is excluded as a successor to the combined entity under the IITA, is applicable to the tax period in question, consistent with the above statutory analysis, and is a permissible construction of the IITA, which must be given legal effect. *See Kean v. Wal-Mart Stores, Inc.*, 235 Ill. 2d 351, 371-73 (2009).

Finally, the Department placed great emphasis on section 405 of the IITA to support its position that the Trust cannot claim the combined entity's net loss carryforward. Section 405 states:

> (a) In the case of the acquisition of assets of a corporation by another corporation described in Section 381(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.
>
> (b) 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 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.

35 ICS 5/405 (footnote omitted).

This provision does not provide strong support for either party's position. On the one hand, it establishes that certain successor corporations and partnerships may take advantage of the predecessor's Article 2 tax benefits, including the section 207 loss carry forward deduction. But it operates primarily as a timing mechanism by providing that such benefits are available "the close of the day of distribution or transfer." 35 ILCS 5/405. Such a provision would be unnecessary for a case like present one, where the applicable tax periods are known in advance.

On the other hand, section 405 does not clearly allow the Trust the tax benefit is seeks. And, ultimately, this is the flaw in the Trust's position. It has the burden to clearly show that it was entitled to the net loss deduction and any lack of clarity should cut against it. *Bodine Electric Co.,* 81 Ill. 2d 513. The Trust has not met its burden to show its entitlement to the net operating loss deduction, and it is not entitled to summary judgment in its favor.

Conclusion

The Petitioner's motion for summary judgment is DENIED. However, this is not a final order. As noted, in responding to the motion for summary judgment, the Department has stated that the Notice of Deficiency is subject to recalculation based on the remaining carryforward from the 2012 year-end tax period and it has requested a remand for that purpose. The matter is set for status on August 29, 2017, at 10:45 a.m., to address this matter.

s/ *Brian Barov*
BRIAN F. BAROV
Administrative Law Judge

Date: July 31, 2017