

CENTER FOR TAX AND BUDGET ACCOUNTABILITY

70 East Lake Street . Suite 1700 . Chicago, IL . 60601 . 312/332-1041 . www.ctbaonline.org

HB 4908 Limitation of the Net Operating Expense Carry Forward

Sponsored by State Representative Larry McKeon (D), HB 4908 revised the Illinois income tax code to limit the Net Operating Loss (NOL) Deduction from 20 to 12 years. Going into effect on January 1, 2004, this new law reduces a corporate tax loophole that cost the state between \$30 and \$50 million per year in corporate tax breaks.

What is the Net Operating Loss Deduction

Added to the Illinois tax code in 1986, the NOL Deduction allowed corporations in Illinois to apply net operating losses back 2 years against their prior income to receive a refund on previous taxes paid or forward up to 20 future years as a deduction against future taxes owed.

Essentially, if a corporation experienced a bad year and had a net operating loss, they were allowed to adjust their taxes retroactively and then get back the taxes they paid during their profitable years. The total cost to the state from this deduction was over \$550 million from Fiscal Years 2001 – 2004.

For example, a corporation that earned \$10,000 in profit in both 2003 and 2004 and then experienced a loss of \$30,000 in 2005 is permitted to file an amended return for 2003 and 2004 and use \$20,000 of the 2005 loss to offset the \$10,000 profit earned in each of those two years. The corporation would then receive a refund of all taxes paid in 2003 and 2004 since the NOL deduction would bring the taxable profit in both years to zero. The unused \$10,000 of the 2005 loss not carried back to 2003 and 2004 could be deducted against any profits earned in tax years 2005 through 2025.

The Illinois loophole tracked federal tax policy, but was very generous compared to other states. For example, about half of the states (24) did not allow corporations to carry backward losses for any amount of time. Sixteen states allow losses to be carried forward much less than the 20 years allowed in Illinois.

The Center for Tax and Budget Accountability (CTBA) served as technical advisor for the bill. Ralph Martire, executive director of CTBA stated, "It's only fair considering that companies were spared during last year's budget crunch while the state slashed health care and education spending."

The new law only modifies the tax code, allowing Illinois corporations to still account for net operating losses on their state income taxes back 2 years. However, on January 1, 2004, corporations are limited to 12 years for deducting losses against any future profits instead of the previous 20.

CTBA thanks Representative McKeon for his sponsorship of the bill. With his help, there is now more state dollars available for programs and services like education, public safety and human services for all Illinois residents.