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Tax Administration

ADVISORY FOR TAX PROFESSIONALS
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Guidance for Tax Pros regarding passive losses and bonus depreciation

PROVIDENCE, R.I. – The Division of Taxation today provides technical guidance regarding the interpretation of the use of passive losses at the state level. There is no provision in statute to support the application of passive losses as a reduction of the bonus depreciation addback under R.I. Gen Laws § 44-61-1.

The Division cautions against the practice of reducing the bonus depreciation addback under R.I. Gen Laws § 44-61-1 for passive losses unavailable on the federal return due to the federal statutory loss limitations. While this practice may result in lower Rhode Island taxable income in the current year and a higher Rhode Island taxable income in a future year, this is not provided for in law. Thus, to remain in compliance with tax obligations and RI law, preparers must follow the federal treatment for passive losses.

Background
Under federal law, passive losses are limited to the amount of recognized passive income in a given tax year. Any excess passive loss would be carried forward on the federal return until passive income was recognized in excess of the current year passive loss.

Following is an example:

	2021		2022	
Current Year Passive Income	$	50,000	$	350,000
Current Year Passive Losses	$	(200,000)	$	(75,000)
Current Year Passive/Income Loss	$	(150,000)	$	275,000
Prior Year Passive Losses	$	-	$	(150,000)
Passive Income/Loss per Return	$	-	$	125,000
Passive Loss Carryforward per Federal Return	$	(150,000)	$	-

Explanation
Rhode Island tax calculations are based on Federal Taxable Income for corporate income tax purposes and Federal Adjusted Gross Income (AGI) for personal income tax purposes. There are some statutory modifications made to federal income including the bonus depreciation addback enumerated in R.I. Gen Laws § 44-61-1.

The limitation on passive loss recognition for Rhode Island purposes follows the federal recognition as there is no Rhode Island statutory modification related to this component of income. If the bonus depreciation addback is reduced by the passive losses that were limited at the federal level, this would create a difference between the amount of passive loss recognized on the federal return and the amount recorded for RI purposes. This difference would need to be tracked and accounted for separately to be reflected on a future tax return. This would result in having to adjust future bonus depreciation reductions/additions for the passive loss adjustment incorrectly taken against the statutorily required addback. There is no statutory authority in § 44-61-1 or in Chapters 44-30 or 44-11 for this practice.

The following table provides an example of how Federal and Rhode Island returns should interact in a passive loss scenario:

Federal	2021	2022
Current Year Passive Income	$ 50,000	$ 250,000
Current Year Passive Losses	$ (200,000)	$ (25,000)
Current Year Passive/Income Loss	$ (150,000)	$ 225,000
Prior Year Passive Losses	$ -	$ (150,000)
Passive Income/Loss per Return	$ -	$ 75,000
Federal Non-passive Income/Loss	$ 85,000	$ 35,000
Federal Taxable Income	$ 85,000	$ 110,000
Passive Loss Carryforward per Federal Return	$ (150,000)	$ -
State		
RI Return Line 1	$ 85,000	$ 110,000
RI Bonus Depreciation Addback	$ 15,000	$ -
RI Bonus Depreciation Deduction	$ -	$ 3,000
Adjusted Taxable Income	$ 100,000	$ 107,000

Summary

The limitation on passive losses exists under federal statute. The recognition and timing of the usage of passive losses is thus controlled by federal statute together with its inclusion in Federal Taxable Income/Federal AGI. The calculation of Rhode Island Taxable Income begins with Federal Taxable Income/Federal AGI. Specific statutory modifications are enumerated to make the necessary adjustments to arrive at Rhode Island Taxable Income including the decoupling from the federal provisions for bonus depreciation. There is no enumerated modification related to the recognition of additional passive loss income thus the examples above should be followed for this scenario.

Additional Notes

1. The use of bonus depreciation is an election at the federal level. There is no statutory requirement to take advantage of this accelerated depreciation method. Thus, in years where the taxpayer has a loss on their federal return or expected reoccurring losses, it may not be in the taxpayer's best interest to increase a loss on their federal return that will create an additional tax liability at the state level.

2. There is no limitation to the carryforward of passive losses at the federal level. As mentioned above, there is no statutory provision for this loss usage in state tax provisions. Thus, the unlimited carryforward provision under federal law would also apply at the state level.

For questions regarding the treatment of passive losses, contact the Division's Personal Income Tax - Taxpayer Assistance Section by email: Tax.Assist@tax.ri.gov, and phone: 401.574.8829, option #3 between 8:30 a.m. and 3:30 p.m. on business days.

The Rhode Island Division of Taxation, part of the Rhode Island Department of Revenue, is open to the public from 8:30 a.m. to 3:30 p.m. business days. For more information, contact the Division of Taxation at (401) 574-8829 or see https://tax.ri.gov/about-us/contact-us.