Corporations disallowed a federal wage deduction for the Employee Retention Credit are eligible for a subtraction modification as provided in IITA Section 203(b)(2)(I)(ii). (This is a GIL.)

February 23, 2022

Re: Illinois income tax

Dear NAME:

This is in response to your letter dated February 10, 2022, in which you request information regarding Illinois income tax. The nature of your request and the information you have provided require that we respond with a General Information Letter ("GIL"), which is designed to provide general information, is not a statement of Department policy, and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.tax.illinois.gov.

Your letter states as follows:

> I would like to request a General Information Letter regarding IITA Section 203(b)(2)(I). This section deals with the deductibility of several federally disallowed deductions; in particular IITA 203(b)(2)(I)(ii) as it relates to Section 280C of the Internal Revenue Code.
>
> Section 2301 of the CARES Act of the IRC provides a fully refundable tax credit known commonly as the Employee Retention Credit (ERC). Section 2301(e) states that "rules similar to the rules of sections 51(i)(1) and 280C(a) of the Internal Revenue Code of 1986 shall apply." Furthermore, according to the IRS Covid-19-Related Employee Retention Credits: Special Issues for Employers FAQ's, their response to Question 85 again refers to section 280C(a) stating "a similar deduction disallowance would apply under the Employee Retention Credit, such that an employer's aggregate deductions would be reduced by the amount of the credit as a result of this disallowance rule."
>
> The instructions for 2021 Schedule M (for businesses) give line specific instructions as follows: Lines 16a through 16g – Expenses of federally tax-exempt income and federal credits – Enter the amount "of any expenses that were disallowed as federal deductions because the income was exempt from federal tax or because a credit was allowed under IRC Sections 45G(e)(3), 171(a)(2), 265, 280C, 291(a)(3), 807(a)(2)(B), 807(b)(1)(B), or 832(b)(5)(B)(i)." This particular line instruction does not directly refer to IRC Section 2301(e) of the CARES Act.

I am requesting a GIL clarifying whether businesses, in particular S-corporations, can take a subtraction equal to the amount of their wage disallowance as it pertains to the Employee Retention Credit. Since the IRS took the position that it is to be treated "similar" to the rules of Section 280C(a) will the Illinois Department of Revenue take the same position and allow a subtraction on Schedule M for the amount of disallowance as it related to the federal ERC? If so, is this subtraction to be reported on Schedule M Line 16d Expenses related to certain federal credits or would it appear elsewhere on the return?

Thank you kindly for your assistance on this matter. Should you need additional information I can be contacted at ###-###-#### or via email at E-MAIL.

RULING

Section 2301(e) of the Coronavirus Aid, Relief, and Economic Security ("CARES") Act provides that "for purposes of this section, rules similar to the rules of sections 51(i)(1) and 280C(a) of the Internal Revenue Code of 1986 shall apply" for purposes of administering the Employee Retention Credit. (CARES Act, Pub. L. No. 116-136, 134 Stat. 281) Section 280C(a) of the Internal Revenue Code ("IRC") provides a rule for employment credits that "no deduction shall be allowed for that portion of wages or salaries paid or incurred for the taxable year which is equal to the sum of the credits determined for the taxable year under sections 45A(a), 45P(a), 45S(a), 51(a), and 1396(a)." (IRC §280C(a))

Notice 2021-20 issued by the Internal Revenue Service ("IRS") provides guidance on the Employee Retention Credit as it applies to qualified wages paid after March 12, 2020, and before January 1, 2021. As explained in Section F of the Notice, "section 280C(a) of the Code generally disallows a deduction for the portion of wages or salaries paid or incurred equal to the sum of certain credits determined for the taxable year. Accordingly, a similar deduction disallowance applies under section 2301(e) of the CARES Act with regard to the employee retention credit, such that an employer's deduction for qualified wages, including qualified health plan expenses, is reduced by the amount of the employee retention credit." (Notice 2021-20 p. 13-14)

For corporations, Section 203(b)(2)(I) of the Illinois Income Tax Act ("IITA") currently allows a subtraction from their adjusted gross income:

> With the exception of any amounts subtracted under subparagraph (J), an amount equal to the sum of all amounts disallowed as deductions by (i) Sections 171(a)(2) and 265(a)(2) and amounts disallowed as interest expense by Section 291(a)(3) of the Internal Revenue Code, and all amounts of expenses allocable to interest and disallowed as deductions by Section 265(a)(1) of the Internal Revenue Code; and (ii) for taxable years ending on or after August 13, 1999, Sections 171(a)(2), 265, 280C,

> 291(a)(3), and 832(b)(5)(B)(i) of the Internal Revenue Code, plus, for tax years ending on or after December 31, 2011, amounts disallowed as deductions by Section 45G(e)(3) of the Internal Revenue Code and, for taxable years ending on or after December 31, 2008, any amount included in gross income under Section 87 of the Internal Revenue Code and the policyholders' share of tax-exempt interest of a life insurance company under Section 807(a)(2)(B) of the Internal Revenue Code (in the case of a life insurance company with gross income from a decrease in reserves for the tax year) or Section 807(b)(1)(B) of the Internal Revenue Code (in the case of a life insurance company allowed a deduction for an increase in reserves for the tax year); the provisions of this subparagraph are exempt from the provisions of Section 250.

Substantially identical provisions are included in Section 203 of the IITA for taxpayers other than corporations.

As a deduction disallowance would apply under Section 2301(e) of the CARES Act with regard to the Employee Retention Credit similar to the rules of Section 280C(a) of the IRC, corporate taxpayers are allowed to subtract the amount of wage deduction disallowed under Section 280C(a) as it pertains to the Employee Retention Credit as provided in IITA Section 203(b)(2)(I)(ii). This subtraction is available on the 2021 Schedule M Other Additions and Subtractions (for businesses), Step 3, Line 16d “expenses related to certain federal credits.”

As stated above, this is a GIL. A GIL does not constitute a statement of Department policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department.

Sincerely,

Jennifer Uhles
Associate Counsel (Income Tax)