2021-2022 General Assembly

HOUSE BILL 243: Budget Technical Corrections, Sec. 20.15: Allow State Income Tax Deduction for Employers Who Took the Federal Payroll Tax Credit for Employee Retention in lieu of a Federal Income Tax Deduction Where North Carolina has No Similar Tax Credit

Committee:		**Date:**	March 30, 2022
Introduced by:		**Prepared by:**	Cindy Avrette
Analysis of:	Sec. 20.15 of S.L. 2022-6		Staff Attorney

OVERVIEW: Section 20.15 of S.L. 2022-6 is a technical change to fix an issue in the State individual and corporate income tax laws caused by the way the employee retention credit was setup and administered at the federal level. The technical change allows a State tax deduction that is intended and assumed under current law.

This section is effective retroactively for taxable years beginning on or after January 1, 2020.

CURRENT LAW AND BILL ANALYSIS: Congress enacted the Employee Retention Tax Credit (ERC) in 2020 to offset federal payroll tax. Generally, this relief would have been allowed as an income tax credit but allowing it to be claimed against the payroll tax enabled employers to receive the benefit of the credit much quicker. The IRS requires that the employer's federal income tax deduction for wages be reduced by the amount of the payroll tax credit. As a general principle, federal law requires a taxpayer to reduce deductions where the taxpayer has taken a credit in lieu of a deduction. This prevents the taxpayer from getting a double benefit.

In instances where the State has no comparable tax credit and the taxpayer sees no NC tax benefit from taking the federal credit, the State would normally allow the taxpayer to take a state deduction. Since the federal credit does not produce a NC tax benefit, there is no danger of the taxpayer getting a double benefit by claiming the deduction.

Current NC law includes an adjustment to allow taxpayers to claim a State income tax deduction when a federal deduction has been disallowed because of a federal income tax credit. However, the ERC is not technically an income tax credit but rather a payroll tax credit. Section 21.15 of the act provides that a State income tax deduction is also allowed when the federal income tax deduction is disallowed because of the federal payroll tax credit for employee retention. The ERC is time limited and expired last year.

EFFECTIVE DATE: This section is effective retroactively for taxable years beginning on or after January 1, 2020. The effective date is retroactive to the cover the taxable years for which the credit was in place.