2021-2022 General Assembly

SENATE BILL 105: 2021 Appropriations Act, Sec. 42.4: Conform to Federal Tax Treatment for PPP Loans and Related Business Assistance/IRC Update

Committee:		**Date:**	January 26, 2022
Introduced by:		**Prepared by:**	Trina Griffin
Analysis of:	Sec. 42.4 of S.L. 2021-180		Staff Attorney

***OVERVIEW:** Section 42.4 of S.L. 2021-180 (2021 Appropriations Act) updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2020, to April 1, 2021.*

This section became effective when the act became law on July 1, 2021.

CURRENT LAW: North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[1] The General Assembly determines each year whether to update its reference to the Code.[2] Updating the reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. The General Assembly's decision whether to conform to federal changes is based on the fiscal, practical, and policy implications of the federal changes.

BILL ANALYSIS: Section 42.4 of S.L. 2021-180 updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2020, to April 1, 2021. The update of the Code reference results in the following changes:

Conformity.

- Conforms the State's **medical expense deduction** to the permanent lowering of the threshold for taking the federal medical expense deduction from 10% of AGI to 7.5%. This deduction allows a taxpayer to deduct unreimbursed medical expenses that exceed 7.5% of the taxpayer's AGI. The "floor" for the medical expense deductions has fluctuated during recent years between 7.5% and 10%. The floor was scheduled to return to 10% for the 2021 taxable year. The Consolidated Appropriations Act, 2021, enacted on December 27, 2020, made the 7.5% floor permanent.

- Conforms to the federal tax treatment afforded expenses using **PPP loans and other federal pandemic-related assistance**. Specifically, it allows individual and corporate taxpayers an income tax deduction for expenses paid using a loan forgiven under the Paycheck Protection

[1] North Carolina first began referencing the Internal Revenue Code in 1967, the year it changed its taxation of corporate income to a percentage of federal taxable income.

[2] The North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1) of the Constitution provides in pertinent part that the "power of taxation … shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would be invalidated as an unconstitutional delegation of legislative power."

Program or the Economic Injury Disaster Loan (EIDL) program, or Shuttered Venue and Restaurant Revitalization grants. However, this provision limits the treatment through 2022. *(See Section 42.4(d)).*

Decoupling.

The update decouples from the following provisions that were enacted or extended by Congress under either the Consolidated Appropriations Act, 2021 (CAA), or the American Rescue Plan Act of 2021 (ARPA):

- ***Charitable Giving.*** – The following two items maintain NC's current policy of decoupling from provisions originally enacted by Congress under the CARES Act related to charitable giving. One affects itemizers and the other affects nonitemizers:
    - For itemizers, there is a temporary suspension of the 60% AGI limitation with respect to the deduction for certain cash charitable contributions at the federal level. Under prior law, if the aggregate amount of an individual's contributions for the year exceeded 60% of AGI, then the excess was carried forward and treated as a deductible charitable contribution in each of the five succeeding tax years.

      Under the CARES Act, to encourage charitable giving during the COVID-19 pandemic, taxpayers were permitted to deduct 100% of cash contributions made to a qualified public charity during 2020. NC decoupled from this provision, meaning that taxpayers were limited to deducting 60% for tax year 2020 and carrying forward the excess. The CAA extended this temporary suspension for 2021; under this section, NC will continue to decouple from this provision.
    - For nonitemizers, the CARES Act created an above-the-line deduction for charitable contributions of up to $300. The CARES Act did not specifically address how the deduction applied to a married couple. NC decoupled from this provision last year.

      Under the CAA, Congress made this provision permanent and clarified that the deduction applied to each person, allowing MFJ filers to deduct up to $600. Additionally, this deduction was converted to a below-the-line deduction. As such, NC need not take any legislative action to decouple since the starting point for calculating North Carolina taxable income is federal AGI. As a practical matter, nonitemizers will not be able to take this deduction at the State level.
- ***Mortgage Insurance.*** – Deduction for mortgage insurance premiums treated as interest for taxpayers who itemize. The General Assembly has decoupled from this provision every year since 2014.
- ***Principal Residence Indebtedness.*** – Income exclusion for the discharge of qualified principal residence indebtedness through 2025. The General Assembly has decoupled from this provision every year since 2014.
- ***Student Loans.*** – Two provisions relate to student loans:
    - Income exclusion for employer payments of student loans. The General Assembly decoupled for tax year 2020.
    - Income exclusion for the discharge of a student loan in 2021-2025. This was a new provision under ARPA.

- ***"Business Lunches."*** – 100% deduction for business related expenses for food and beverages provided by a restaurant for 2021 and 2022. NC will continue to allow a 50% deduction for these expenses.

EFFECTIVE DATE: This section became effective when the act became law on July 1, 2021.