

IT 25-0004-GIL 05/06/2025 INCOME TAX - SUBTRACTIONS

Subtraction modification may be claimed in the same tax year a taxpayer receives the Employee Retention Credit and reports an overstated wage expense amount as gross income on its federal return for the disallowed wage deduction. (This is a GIL.)

May 6, 2025

NAME  
COMPANY  
EMAIL

Re: Illinois Income Tax – Federal Employee Retention Credit and Illinois Subtractions

Dear NAME:

This letter is in response to your email dated April 7, 2025, in which you requested information regarding the Federal Employee Retention Credit and the corresponding Illinois subtractions. The Department issues two types of letter rulings. Private Letter Rulings (“PLRs”) are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department’s regulations at 2 Ill. Adm. Code Section 1200.110. The purpose of a General Information Letter (“GIL”) is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code Section 1200.120(b) and (c). You may access our website at <https://tax.illinois.gov/> to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

I am writing to confirm that the subtraction provided by Section 35 ILCS 5/203(b)(2)(I) for ERC related wages disallowed by IRC Section 280C would apply in the year the credit is approved.

Illinois GIL IT-22-0001 confirms this treatment generally. It states, “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).”

Some taxpayers filed retroactive ERC claims, yet did not amend their federal returns to disallow the wages generating the credit due to the uncertainty as to whether they would be approved. For taxpayers in this situation, the IRS has recently issued updated FAQ’s. Rather than requiring such taxpayers to amend prior year returns to reduce salary deductions which generated a credit, the Department is allowing taxpayers to recognize the increase in income in the year the credit is received.

If an ERC credit is approved and claimed in 2024 or thereafter, and an increase in taxable income is recognized on the 2024 federal income tax return (or relevant post 2021 tax year), will Illinois allow a subtraction for the wages disallowed under Section 280C(a)?

Thank you for your assistance.

### **RULING**

Section 203 of the Illinois Income Tax Act (“IITA”) [35 ILCS 5/101 *et seq.*] provides that a taxpayer’s base income is equal to its federal taxable income (or adjusted gross income, in the case of an individual taxpayer), modified as provided in that section. IITA Section 203(h) provides:

Legislative intention. Except as expressly provided by this Section there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise.

For corporations, IITA Section 203(b)(2)(I) currently allows a subtraction from federal taxable 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.

The Department issued a General Letter Ruling on February 23, 2022, allowing corporations to subtract from federal taxable income the amount of federal wage deduction disallowed under Internal Revenue Code ("IRC") section 280C(a) as it pertains to the Employee Retention Credit ("ERC"). (See IT-22-0001-GIL.) Taxpayers must generally reduce their deduction for wage expense by the amount of the ERC in the taxable year in which the qualified wages were paid or incurred. (See IRS Notice 2021-49.)

On March 20, 2025, the Internal Revenue Service updated its [Employee Retention Credit FAQs](#) outlining the procedures on how to correct mismatched wage expenses. (See Questions 1 – 3 under the "Income tax and ERC" section of the FAQs.) If a taxpayer claimed the ERC but did not reduce wage expense on its income tax return, and the ERC claim was paid in a subsequent tax year, the IRS will permit the taxpayer to adjust the wage expense in the year the ERC claim is paid. The taxpayer is not required to file an amended return, or if applicable, an administrative adjustment request to address the overstated wage expenses. Rather, a taxpayer may include the overstated wage expense amount as gross income on the income tax return for the taxable year in which the ERC was received. The FAQs note that this amount is to be included in gross income due to the tax benefit rule. The application of this rule corrects a taxpayer's excess wage expense on the income tax return for the tax year in which it received the ERC, rather than limiting corrections to income tax returns for a prior year in which the ERC was claimed. Similarly, if a taxpayer's ERC claim was disallowed and the wage expense was reduced by the amount of ERC expected on the income tax return for the year the ERC was claimed, the IRS will permit the taxpayer to increase wage expense in the year the claim disallowance is final.

IRC section 111(a) deals with the recovery of certain items previously deducted:

Gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by this chapter.

The IITA makes no express provision for a “tax benefit rule”. Accordingly, IITA Section 203(h) prohibits the allowance of any subtraction based on the tax benefit rule. As there is no subtraction modification permitting corporations to exclude from Illinois base income an amount included in federal taxable income pursuant to IRC Section 111 as a recovery of an item of income previously deducted, such a deduction cannot be taken on the Illinois return.

However, while the IRS ERC FAQs are not authoritative, the Department will recognize the process as outlined by the IRS in this very limited situation. In general, the wage expense deduction is disallowed in the year the qualified wages are paid or incurred and the related credit is claimed federally. It is then that a taxpayer would be allowed to claim a subtraction modification on its Illinois tax return for that same tax year. With regard to the ERC, the IRS implemented processes to verify valid claims against potential fraud and abuse of the credit and shifted the moratorium period on new claims from September 14, 2023, to January 31, 2024. The IRS has acknowledged that most claims showing an increased risk of being incorrect needed additional review or information to confirm a business’s eligibility for the credit. Therefore, the wage expense deduction is effectively disallowed in the year the ERC is awarded by the IRS since that is when the credit has been verified by the IRS and received by the taxpayer.

In consideration of the IRS guidance and verification process, if an ERC is approved and paid by the IRS in a tax year subsequent to the tax year that the taxpayer originally claimed the ERC and the taxpayer did not reduce the wage expense deduction for that tax year, then the Department will allow a corporate taxpayer to claim a subtraction modification pursuant to IITA Section 203(b)(2)(I)(ii), in the same tax year the taxpayer reported the overstated wage expense amount as gross income on its federal return, for the amount of the wage expense deduction that would have been disallowed under IRC section 280C(a) on the originally filed federal tax return. Taxpayers other than corporations may claim the subtraction modification as allowed in the substantially identical provisions in IITA Section 203. The subtraction modification is subject to Department verification. Upon request by the Department, taxpayers must provide support that the overstated wage expense amount was included as gross income on the federal income tax return for the taxable year in which the ERC was received by the taxpayer. This support includes, but is not limited to, documentation which clearly reflects the wage expense deduction and ERC claimed on the original return, the tax year in which the ERC was received by the taxpayer, the amount

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of the ERC paid by the IRS, and the overstated wage deduction amount included as gross income for the tax year the ERC was received by the taxpayer.

As stated above, this is a General Information Letter. A General Information Letter does not constitute a statement of Department policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you require additional information, please visit the Department's website at <https://tax.illinois.gov/> or contact the Department's Taxpayer Assistance Division at 800-732-8866.

Sincerely,

Jennifer Uhles  
Associate Counsel

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