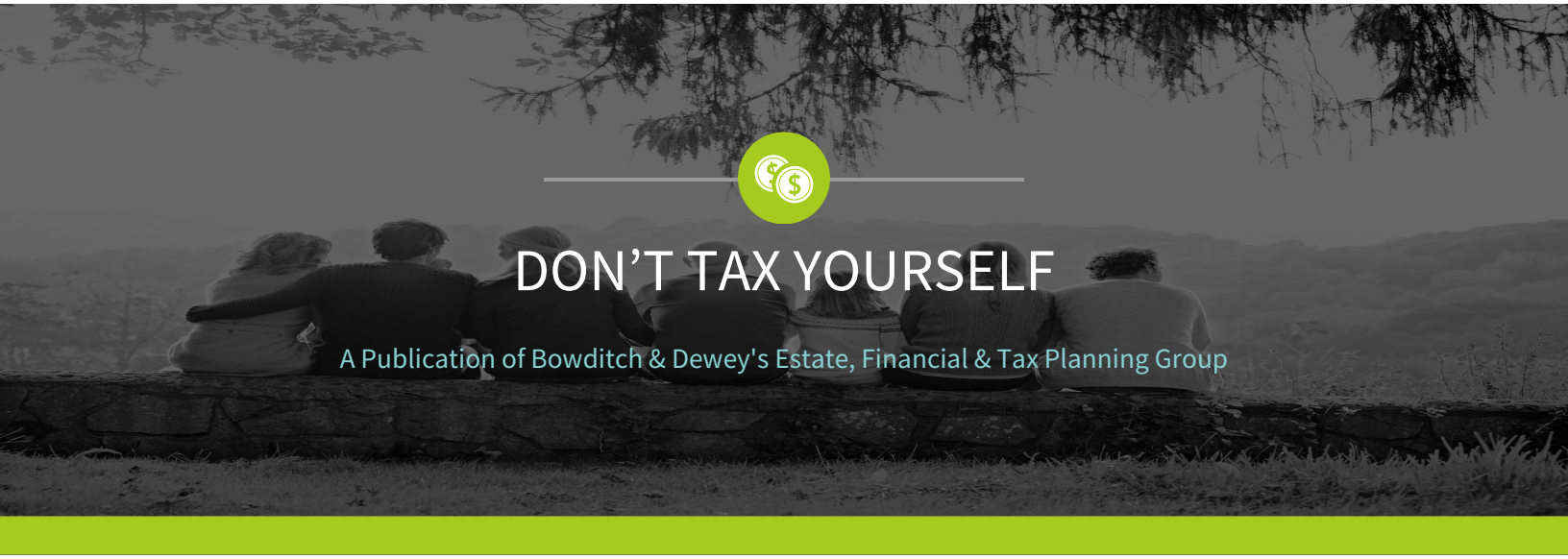

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IRS and Treasury Updated Guidance on Deductibility of Expenses Paid for with PPP Loan Proceeds

BY BOWDITCH & DEWEY • NOVEMBER 23, 2020

On November 18, the Internal Revenue Service and Treasury Department issued updated guidance on the tax deductibility of business expenses paid for with loan proceeds from the CARES Act Paycheck Protection Program (PPP). In Revenue Ruling 2020-27, the IRS confirmed that a taxpayer *cannot* deduct such expenses "if the taxpayer reasonably expects to receive forgiveness of the covered loan based on otherwise deductible expenses." With this Ruling and Notice 2020-32 issued in May, the IRS has cemented its position that otherwise eligible expenses paid for with forgivable PPP loan proceeds are not tax deductible under the Internal Revenue Code of 1986.

Section 1106(i) of the CARES Act specifies that "any amount which… would be includible in gross income of the eligible recipient by reason of [PPP loan] forgiveness … shall be excluded from gross income." With this language, the Act provided a tax benefit to PPP Loan recipients: it exempted them from cancellation of indebtedness income that typically arises upon the forgiveness of a loan. By denying a tax deduction for business expenses associated with the CARES Act PPP Loan, the IRS has taken away this tax benefit. For example, if a corporation receives a $1,000,000 PPP loan, without the CARES Act debt forgiveness provision, the business would pay $210,000 in corporate tax upon the PPP loan's forgiveness. The IRS adds back this $210,000 tax (the tax benefit of a deduction is 21% of the $1,000,000 in expenses) in denying a tax deduction for business expenses paid with the $1,000,000 PPP Loan.

On November 18, the IRS also issued Revenue Procedure 2020-51 to provide a safe harbor for taxpayers who reasonably expect PPP loan forgiveness but either ultimately never request such loan forgiveness or are denied loan forgiveness. A taxpayer so described may be able to deduct some or all of the eligible expenses on the taxpayer's timely filed, including extensions, original income tax return for the 2020 taxable year, an amended return or an administrative adjustment request under section 6227 of the Code, or the taxpayer's timely filed income tax return for the 2021 tax year.

The House of Representatives included a proposed legislative change to allow for the deductibility of business expenses paid for with forgivable PPP Loan proceeds. Section 20235 of the HEROES Act states, "for purposes of the

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Internal Revenue Code of 1986 and notwithstanding any other provision of law, any deduction and the basis of any property shall be determined without regard to whether any amount is excluded from gross income under section 20233 of this Act or section 1106(i) of the CARES Act." This legislation, however, has stalled in the Senate. A quick fix is warranted to preserve the tax benefit Congress originally intended in their passage of the CARES Act for small businesses who borrowed through the Paycheck Protection Program.

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