

## Tax Notes

# Are Expenses Related to Forgiven PPP Loans Deductible?

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*This is part of a continuing series updating our clients regarding the effects on tax filings due to COVID-19. You can access our COVID-19 Resource Center [here](#).*

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The answer appears to be **NO**, although some groups, including bipartisan Congressional leaders, do not agree. The IRS released Notice 2020-32 on April 30, 2020 which provides that for federal income tax purposes, expenses paid relating to a forgiven Paycheck Protection Program (PPP) loan are non-deductible including rent, utilities, interest and payroll costs.

This unfavorable taxpayer position – although somewhat expected by many tax practitioners – has been met with strong criticism by the AICPA and several Congressional leaders challenging the IRS' interpretation asserting that it is contrary to the overall intent of the CARES Act (the Act).

### Background

The CARES Act became law on March 27, 2020 in order to provide stimulus relief to affected taxpayers. Overall, the Act provides federal support to small businesses impacted by the pandemic through the use of SBA loans to qualifying small businesses. The PPP loans are designed for the recipient to receive forgiveness of ALL of the indebtedness as long as the proceeds from the loan are used to pay payroll costs, interest on certain mortgage obligations, rent and utilities during the 8-week "covered period" after loan is received. Amounts forgiven would be excluded from the borrower's gross income. For more information of the loan forgiveness provisions, please see [our article](#).

### Notice 2020-32

Prior to the issuance of the [IRS Notice](#), no mention was made in the CARES Act as to the deductibility of the expenses throughout the covered period. Many taxpayers and their advisors had assumed that the expenses would be deductible as they were trade or business expenses, deductible under IRC §162 or deductible as interest expense via IRC §163. However, the IRS Notice explains that no deduction is allowed for the payment of an expense that results in loan forgiveness, which would ultimately lead to a "double benefit." One way to look at this point of view is as if the government is simply arranging to pay the salaries and related expenses directly through this loan platform. Succinctly put: no taxable income, no offsetting deduction.

The IRS supports its position by citing IRC §265(a)(1) and Revenue Ruling 83-3 which disallow deductions that relate to reimbursed or tax-exempt income. Where the funds received from the PPP loan have been earmarked to be forgiven, no deduction is available.

**Illustration:** Company ABC applies for and obtains a PPP loan for \$1 million and uses the funds to pay expenses in a manner in which the loan is completely forgiven under the CARES Act. Under this fact pattern, the loan forgiveness is excluded from income and all the expenses paid out of the forgiven proceeds during the covered period cannot be deducted. Clearly, this decreases the value of the loan. But, in most cases, companies like ABC will not be generating sufficient income to produce a profit, and allowing the expenses to be deducted would only create an operating loss for the year.

## Opposing Position

The AICPA and Congressional leaders do not agree with the IRS' interpretation and are pushing for a legislative change as part of the next stimulus bill. It is their belief that the overall intent of the CARES Act was to stimulate the economy during these difficult times and the disallowance of expenses such as these is contrary to the intent of the Act as legislated by Congress.

## What Now?

Several top lawmakers have commented that they would like this rule changed, criticizing the Treasury for the lack of deductibility of these PPP expenses. It is likely that this specific issue will be addressed further in a "Phase 4" or "CARES 2" package. Thus, we will wait and see.

## Wishful Thinking...

If legislation passes and the expenses become deductible, there may be loss carryback possibilities. This would put more money into the hands of businesses. Only time will tell.

## Contact Us

PKF O'Connor Davies is monitoring the situation in Washington, DC and as guidance changes we will keep you informed. If you have any questions, please contact the partner in charge of your account or:

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