

Tax Notes

IRS Updates Guidance on Tax Deductibility of PPP Expenses

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The IRS issued a new ruling and procedural guidance on November 18, 2020 in the form of [Revenue Ruling 2020-27](#) and [Revenue Procedure 2020-51](#), announcing guidance on the tax deductibility of expenses related to Paycheck Protection Program (PPP) loans that have not yet been forgiven. The new releases provide significant clarity for many taxpayers whose businesses were affected by the COVID-19 pandemic, for whom the deductibility of PPP expenses will be an important issue for their 2020 tax returns. The IRS ruling indicates that taxpayers who paid otherwise deductible expenses with PPP funds may not deduct them on their 2020 tax return if they reasonably expect that their PPP loan will be forgiven.

Background

The PPP program, as part of the [CARES Act](#) and later the [PPP Flexibility Act](#), provided businesses with loans, which were forgivable if they were used for specified business expenses (primarily payroll, along with rent or mortgage expenses and utilities). While, for financial statement purposes, the expenses paid for by PPP loans may reduce net income in 2020, with an offsetting income inclusion when the loan is forgiven, for tax purposes, the CARES Act specified that the forgiveness of the loan would not create taxable income.

In May, the IRS issued [Notice 2020-32](#), which takes the position that a deduction is not allowed for expenses related to PPP loans if the loan is forgiven. However, that Notice applied only to amounts that had already been forgiven, leaving open the question of what to do with expenses from loans that had not yet been forgiven. When the PPP Flexibility Act, which became law after the IRS issued Notice 2020-32, extended the time to file for forgiveness until late 2021, it became very likely that many taxpayers will not have received a forgiveness determination by the time they file their 2020 tax return. We discussed the uncertainty on how taxpayers should approach these scenarios in a [webinar](#). **The new IRS ruling and related guidance provide answers.**

Reasonable Expectation of Forgiveness

The Revenue Ruling considers two scenarios. In both, a calendar year taxpayer has received a PPP loan and used the proceeds for covered expenses during its covered period. As a result, the taxpayer “reasonably expects to receive forgiveness.” In Scenario 1, the taxpayer has applied for forgiveness before the end of 2020, but did not receive a determination before the end of 2020. In Scenario 2, the taxpayer did not apply for forgiveness before the end of 2020, but waited until 2021.

The IRS, in both scenarios, indicates that the expenses related to the PPP loan should not be deducted on the taxpayer’s 2020 tax return. The deciding factor in both scenarios is that the taxpayer reasonably expects to receive forgiveness. This eliminates the potential to protect the deductibility of these expenses in the calculation of 2020 taxable income simply by delaying the application for forgiveness until 2021.

Revenue Procedure 2020-51 provides a safe harbor for taxpayers to later deduct expenses related to a PPP loan if they reasonably expected forgiveness but later have their forgiveness application denied in whole or in part, or decide not to seek forgiveness. The expenses can either be deducted on an amended 2020 return or on a return relating to the subsequent tax year when it becomes clear that the taxpayer will not receive forgiveness (likely either 2021 or 2022).

Next Steps

If taxpayers are concerned about the effect of the non-deductible of these expenses in computing their 2020 taxable income, they should conduct an analysis now to determine whether they qualify for forgiveness. If they reasonably expect forgiveness, and the removal of those expenses will create additional taxable income in 2020 (or a significant increase in income), additional year-end planning should be considered, including deferral of income or acceleration of expenses.

Our team is happy to assist in doing an analysis of whether you reasonably expect to receive PPP loan forgiveness, and in doing additional planning if necessary. For a discussion on tax planning in our current economic environment, please join our [Executive Tax Forum](#) on December 3rd.

Contact Us

For assistance with PPP Loan Forgiveness or related tax planning, we invite you to contact your PKF O'Connor Davies advisor or either of the following:

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