

PPP LOAN FORGIVENESS COMES WITH A PRICE: LOST DEDUCTIONS

Posted on May 5, 2020 by Laura E. Krebs Al-Shathir



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For any employer that expected PPP loan proceeds to be “free money,” the IRS has essentially said – not so fast. [In guidance issued on May 1, 2020](#), the IRS clarified that to the extent that an employer makes payments of expenses that result in forgiveness of a PPP loan (namely, payroll, mortgage interest, rent, and utility payments), no deductions are allowed for such expenses, even though they otherwise would have been deductible absent PPP loan forgiveness.

Notice 2020-32

[Section 1106\(i\) of the CARES Act](#) provides that forgiven loan proceeds are not included in gross income.

In Notice 2020-32, however, the IRS cited [Internal Revenue Code Section 265](#) and corresponding Treasury Regulations for the principal that a taxpayer is not allowed to take deductions for expenses that otherwise would have been deductible to the extent that such deduction is allocable to income that is exempt from tax.

Effectively, the IRS is stating that taxpayers should not be able to “double dip” by receiving non-

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taxable PPP funds and also getting to deduct payments made using such funds.

With such a position, the IRS is effectively negating the benefit of forgiven PPP loan proceeds being non-taxable. Unfortunately, many businesses may have taken the CARES Act's exclusion from income of PPP loan proceeds at face value, without anticipating the impact of free money on the deductibility of expenses funded with forgiven loan proceeds.

Consistent with Congressional Intent?

Senate Finance Committee Chairman Chuck Grassley has [spoken out against the IRS's position](#), stating:

"The intent was to maximize small businesses' ability to maintain liquidity, retain their employees and recover from this health crisis as quickly as possible. This notice is contrary to that intent."

Unless the IRS reverses its position, which is unlikely, Congress would need to enact legislation essentially to nullify the IRS position, or a taxpayer would have to successfully challenge the Notice 2020-32, in order for the expenses attributable to forgiven PPP loans to be deductible.

In the meantime, businesses need to carefully plan to ensure that they have sufficient cash to foot the bill associated with non-deductible expenses.

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