COVID-19: Expenses Paid with PPP Loans Are Not Tax-Deductible

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Late on April 30, 2020 the IRS provided rather unwelcome guidance to Paycheck Protection Program (PPP) loan borrowers and potential borrowers. IRS Notice 2020-32 provides that no deduction will be allowed for otherwise deductible expenses (e.g., wages, health insurance, rent, utilities) that are paid with PPP loans that are ultimately forgiven.

Typically, if a loan is forgiven, the borrower benefiting from that forgiveness recognizes income equal to the forgiven amount. The CARES Act specifically provides that forgiven PPP loans will not result in taxable income to the borrower.

Since the Paycheck Protection Program was created, however, practitioners have debated whether expenses paid by loans that are forgiven on a tax-free basis, and whether loan recipients can also deduct the expenses paid via those forgiven loans. On one side of the debate were those who argued, correctly, that traditional tax principles would deny those deductions, specifically Section 265 of the Internal Revenue Code. The other side of the debate reasoned that the PPP is a remarkably untraditional program for an unprecedented situation; if Congress wanted to give with one hand (SBA) and take with the other (IRS) it would have said so. To the vast majority of borrowers, the economic impact of denying deductions may be largely the same as the economic impact of treating the forgiven loan as taxable.

For now, the IRS is on the side of the traditionalists.
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