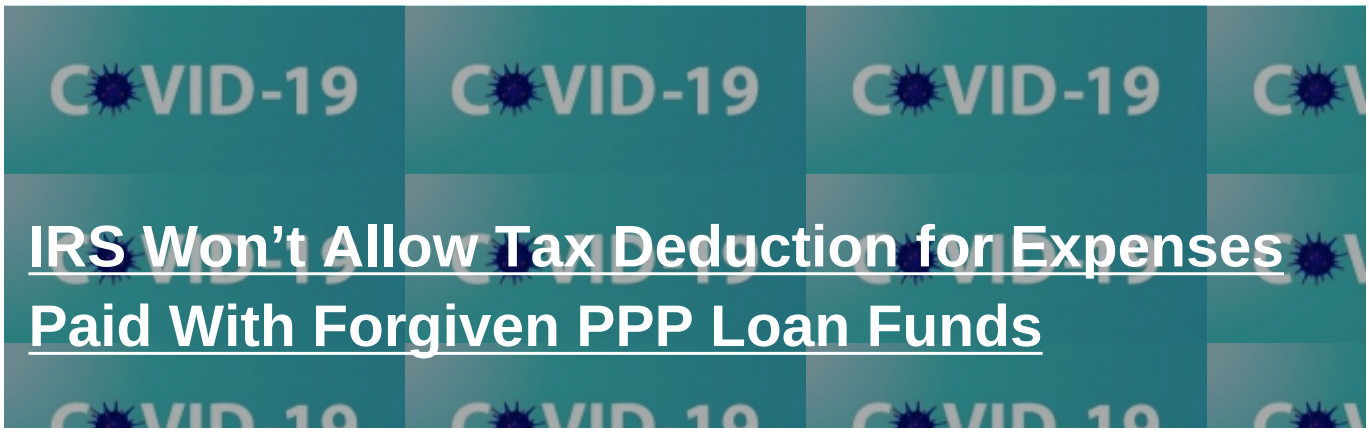


IRS Won't Allow Tax Deduction for Expenses Paid With Forgiven PPP Loan Funds

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By Heath Hoobing & John Fuchs

On May 1, 2020, the Internal Revenue Service announced that business expenses paid with a forgiven federal Small Business Act (SBA) loan are not deductible. As we reported in a previous post, the federal CARES Act significantly expanded the SBA Section 7(a) loan program by creating a new Paycheck Protection Program (PPP). PPP loans are available to many businesses that may have not previously qualified for an SBA loan.

Additionally, subject to some exceptions, the SBA will forgive a portion of the PPP loan equal to the amount paid or incurred by the business for payroll, rent, utilities, and mortgage interest during the 8-week period beginning on the loan's origination date. Generally, unless an exception applies, loan forgiveness results in federally taxable income to the debtor. But under a special PPP exception, businesses are not required to include the amount of PPP loan forgiveness in gross income for federal income tax purposes.

Businesses must use PPP loan funds to pay only the following expenses:

- Payroll costs;
- Costs related to the continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums;
- Employee salaries, commissions, or similar compensation;
- Payment of interest (but not principal) on any mortgage obligation;
- Rent;
- Utilities; and
- Interest on any other debt obligations incurred before February 15, 2020.

Ordinarily, a business may deduct these expenses on its federal income tax return. However, the IRS has determined in Notice 2020-32 that allowing an income tax deduction for expenses funded with tax-exempt PPP loan funds would result in a double tax benefit not permitted by federal tax law. Therefore, if a business pays the above expenses with PPP loan funds that are granted loan forgiveness, the business cannot also take an income tax deduction for those same expenses.

It appears based on this notice that if the PPP loan is not forgiven, but rather treated as a loan under its original terms, then any expenses paid from the non-forgiven loan funds would not be subject to this deduction prohibition.

The CARES Act does not address the deductibility of expenses paid with forgiven loan funds. Several members of Congress indicated this announcement is inconsistent with the intent in passing the CARES Act. However, the ultimate resolution of this issue will most likely require a Congressional amendment to the CARES Act or a taxpayer's challenge in federal court. Businesses should evaluate the full benefit of the PPP program and the loss of the deductibility of these expenses in determining their business' participation in the PPP program, and should consider whether to file a protective claim for refund of federal income taxes based on the potential deductibility of these expenses in the future.

This article is general in nature and does not constitute legal advice. Please note that new guidance is being provided by authorities on a daily basis so please monitor new developments and guidance. Readers with legal questions about how this guidance applies to your business should consult the author, Heath Hoobing (hhoobing@sb-kc.com), or your regular contact at Seigfreid Bingham at 816-421-4460.

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