

IRS Notice Causes Concern on Use of SBA Paycheck Protection Program Funds

The rules and guidance regarding the Small Business Administration's (SBA) Paycheck Protection Program (PPP) loans authorized in the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) continue to evolve.

The CARES Act provides that, "an eligible [PPP loan] recipient shall be eligible for forgiveness of indebtedness on a covered loan in an amount equal to the sum of" payroll, mortgage interest, rent and utilities (all as defined in the CARES Act) incurred and paid during an eight week period following the funding of the loan. It also provides that, "For purposes of the Internal Revenue Code of 1986, any amount which (for this subsection) would be includible in gross income of the eligible recipient by reason of forgiveness described in subsection (b) shall be excluded from gross income." In other words, the forgiveness of the PPP loan will not result in taxable income to the borrower.

However, the CARES Act was silent regarding the tax treatment of the expenses paid with PPP loan proceeds that were subsequently forgiven. On April 30, 2020, the IRS issued guidance ([Notice 2020-32](#)) regarding the tax treatment of expenses paid with PPP loan proceeds. The notice "clarifies" that:

...no deduction is allowed under the Internal Revenue Code (Code) for an expense that is otherwise deductible if the payment of the expense results in forgiveness of a covered loan...and the income associated with the forgiveness is excluded from gross income for purposes of the Code...

This guidance means that expenses paid using PPP loan proceeds that are later forgiven will not be deductible for tax purposes.

Prior to the IRS clarification, you may have been expecting a tax "benefit" generated by the deductibility of expenses paid using PPP loan proceeds. Since the loan forgiveness is not taxable (and still is not taxable), deducting expenses paid with forgiven loan proceeds would have resulted in a net tax benefit because the expenses would have been deducted without recognizing any revenue (i.e., the normally taxable loan forgiveness income).

Based on this new guidance (and assuming it is not subsequently changed), your company will still not recognize loan forgiveness income but will also not be able to deduct expenses paid with the forgiven loan proceeds. This guidance makes the PPP loan forgiveness tax neutral rather than resulting in a tax benefit. Please note that expenses paid with PPP loan proceeds that are not forgiven are still deductible.

Thankfully, Congress appears to be on top of this issue. On May 5, 2020, the chairmen of the House Ways and Means Committee and the Senate Finance Committee sent a [letter](#) to the Secretary of the Treasury. Also, on March 5th Senator John Cornyn (R-TX) and five other Senators introduced [S.3612](#), a bill to clarify for the purposes of the Internal Revenue Code of 1986 that the receipt of coronavirus assistance does not affect the tax treatment of ordinary business expenses.

DTA has also learned that the House of Representatives is planning to address this issue in its Phase 4 COVID-19 package due out sometime this week.