

Publication

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IRS Asserts That Business Expenses Paid with Forgiven Paycheck Protection Program Loans Are Not Deductible

As we previously reported in “Federal and State Tax Actions in Response to COVID-19” and “Requirements and Considerations for Paycheck Protection Program Loans,” the Coronavirus Aid, Relief, and Economic Security (CARES) Act established the Paycheck Protection Program (PPP) to provide loans to qualifying small businesses. On April 30, 2020, the IRS released Notice 2020-32 regarding the deductibility for federal income tax purposes of certain ordinary and necessary expenses incurred in a taxpayer’s trade or business when the taxpayer receives a PPP loan. The IRS Notice provides that expenses that would otherwise be deductible for federal income tax purposes shall be disallowed to the extent of any related PPP loan forgiveness. Citing Section 265 of the Internal Revenue Code, the IRS has taken the position that any expenses incurred with respect to the proceeds of a PPP loan are allocable to a “class of exempt income,” and consequently, are disallowed to prevent a double tax benefit (i.e., the exclusion of the forgiven loan from gross income and the deductibility of expenses incurred with the proceeds of such loan).

Several members of Congress have already noted their disagreement with the IRS position. Noting that the purpose of the CARES Act is to maximize liquidity, employee retention, and business viability, several members of Congress have stated their desire to clarify in future legislation that the use of PPP loan proceeds for

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ordinary and necessary trade or business expenses should be deductible for federal income tax purposes. While we anticipate that this issue will be resolved prior to the filing of any applicable tax returns, Notice 2020-32 currently is the official position of the IRS.

If you have any questions regarding this guidance or any other tax or business-related matters, please do not hesitate to contact Scott Bakal, Jeffrey Shamberg, Robert Gerber, Bruce Fox, Chadwick Hoyt, Thomas Wolford, Michael Gray, David Milligan, Eric McLimore or your Neal Gerber Eisenberg attorney.

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