What IRS Guidance on Deductibility of PPP Expenses Means To You

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The forgiveness of a Paycheck Protection Program (PPP) loan is excludible from taxable income. Earlier this year, the Treasury Department released Notice 2020-32 which states that expenses paid with the proceeds of a forgiven loan should not be deductible for tax purposes, as that would result in a double tax benefit. Many professional tax advisors thought the IRS reasoning behind Notice 2020-32 was not sound and did not match the original intent of Congress when they made forgiven PPP loan proceeds excludible from income. Indeed, the Congressional Budget Office had to "rescore" the cost of the legislation as they assumed the expenses would be allowed as a deduction. All are waiting for additional legislative guidance to clarify this matter. While certain members of Congress, on both sides of the aisle, have voiced opposition to the IRS position, no legislation has been forthcoming to date.

Under the traditional accrual method of accounting, an item is not recognized until it is fixed and determinable. Likewise, under U.S. federal income tax law, the all events test requires that all the events fixing an accrual-method taxpayer's right to receive income or incur expense must occur before the taxpayer can report an item of income or expense. Thus, a loan is a loan until it is forgiven, and one would reason that PPP-funded expenses that are fixed and determinable would be deductible until the loan is actually forgiven. The all events test would tell us that the expenses are deductible until the taxpayer knows the loan is forgiven by the SBA, which could conceivably occur in 2021.

Rev Rul 2020-27 and Rev Proc 2020-51

Apparently, the IRS did not agree and released Rev Rule 2020-27 which in summary states that even if loan forgiveness has not yet been granted by the SBA, if a taxpayer reasonably expects the loan will be forgiven, the related expenses paid are not currently deductible.

Revenue Procedure 2020-51 provides "safe harbors" for taxpayers to be able to deduct expenses whose loan forgiveness has been fully or partly denied. Essentially this means that taxpayers who reasonably expect the loan will be forgiven should not take a deduction for PPP-funded expenses in 2020.

Where does this leave us?

While a Revenue Procedure or Revenue Ruling does not carry the weight of the law, it indicates the IRS thinking on a matter and cannot be ignored. Here are several things to consider:

- It is still expected that legislation will be proposed and passed providing additional Coronavirus stimulus, and that law will contain clarification on this issue.
- When doing your 2020 year-end tax planning and projections, if you have not received word from the SBA regarding forgiveness, a conservative approach applicable to most taxpayers would be to not consider PPP-funded expenses as deductible.
- Short of further guidance on the matter, deducting PPP expenses in 2020 should be accompanied by disclosure of the position in the tax return. This will heighten the matter and could expose a taxpayer to audit. Is it worth the risk if you have to reverse the deduction in 2021 when your loan is forgiven? What if tax rates rise in 2021? If that occurs, a deduction will be more valuable if taken in 2021.
- Since it appears the government is moving the goal posts in the middle of the game, recent developments tell us that for taxpayers with loans over $2,000,000, forgiveness may be anything but assured. What does Rev Rul 2020-27 mean by the phrase taxpayers who “reasonably expect” their loans to be forgiven?
- And lastly, don’t forget the non-tax aspects of the treatment of income and expenses. Not recognizing income and deducting expenses could result in violations of loan covenants. Distributing loan proceeds to partners or shareholders in 2020 without knowing the tax effect of corresponding expenses could leave you and your owners in a bad cash position for 2021.

The Anchin COVID-19 Resource Team continues to monitor ongoing updates to the PPP Program. To better understand how the changes impact your unique situation, please contact your Anchin Relationship Partner or our Anchin COVID-19 Resource Team at COVID19@anchin.com.

Disclaimer: Please note this is based on the information that is currently available and is subject to change.