

IRS Concludes That Expenses Resulting in Paycheck Protection Program Loan Forgiveness Not Deductible

May 05, 2020

Client Advisory

In prior publications we have described the \$349 billion (increased to \$659 billion) Paycheck Protection Program ("PPP") created under the \$2 trillion Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"). Among other things, the PPP provides taxpayers with loans that may be forgiven to the extent of the taxpayer borrower's payroll costs, payments of interest on covered mortgage obligations, payments on covered rent obligations, and covered utility payments made during the 8-week period beginning on the loan origination date (up to the principal amount of the loan).

Although cancelled indebtedness is generally treated as taxable income under the tax code, the CARES Act provides that the amount of any PPP loan forgiveness will not constitute taxable income to the taxpayer borrower. What the CARES Act does not specifically address is whether a taxpayer borrower may deduct otherwise deductible expenses, such as payroll or rent, if the taxpayer borrower's PPP loan is ultimately forgiven as a result of the payment of those expenses.

In Notice 2020-32, the Internal Revenue Service ("IRS") concluded that the taxpayer borrower may not deduct expenses that result in forgiveness of PPP debt. The IRS based its conclusion on its application of section 265(a)(1) of the Internal Revenue Code, which generally disallows deductions for amounts that are allocable to income that is exempt from U.S. federal income tax. The IRS found further support for its conclusion in case law and revenue rulings denying taxpayer deductions for otherwise deductible payments for which a taxpayer is reimbursed.

Some commentators believe that the IRS conclusion regarding the non-deductibility of expenses resulting in PPP loan forgiveness is contrary to Congressional intent and anticipate further legislative action in response.

* * *

For more information concerning the matters discussed in this publication, please contact the authors **Marc A. Kushner** (212-238-8766, kushner@clm.com), **Jerome J. Caulfield** (212-238-8809, caulfield@clm.com), **Jennifer MacDonald** (212-238-8751, macdonald@clm.com), or your regular Carter Ledyard attorney.

*Carter Ledyard has created a COVID-19 Response Group to monitor the evolving legal landscape, address client questions and ensure client compliance with the laws and regulations issued in response to the COVID-19 pandemic. The Carter Ledyard COVID-19 Response Group consists of **Jeffery S. Boxer** (212-238-8626, boxer@clm.com), **Judith A. Lockhart** (212-238-8603, lockhart@clm.com), **Bryan J. Hall** (212-238-8894, hall@clm.com), **Alexander G. Malyshev** (212-238-8618, malyshev@clm.com), **Melissa J. Erwin** (212-238-8622, erwin@clm.com),*

and **Leonardo Trivigno** (212-238-8724, trivigno@clm.com). Clients should contact the attorneys listed above or their regular CLM attorney for any questions concerning legal obligations arising from the COVID-19 pandemic.

related professionals

Jerome J. Caulfield / Partner

D 212 238-8809

caulfield@clm.com