

IRS Rules Expenses Used to Qualify Forgiven PPP Loan Proceeds as Non-taxable are not Deductible for Federal Income Tax Purposes

As you know from our prior email blasts, the Paycheck Protection Program (PPP) was established by section 1102 of the CARES Act. Under the PPP, a recipient of a covered loan may use the proceeds to pay (1) qualified payroll costs including certain employee benefits relating to healthcare and retirement, (2) interest on mortgage obligations, (3) rent, (4) utilities, and (5) interest on any other existing debt obligations.

Under section 1106(b) of the Cares Act, a recipient of a PPP covered loan can receive forgiveness of indebtedness on the loan in an amount equal to the sum of payments made for the following expenses during the 8-week "covered period" beginning on the covered loan's origination date (date of funding of the loan by the bank):

- (1) qualified payroll costs and covered benefits,
- (2) any payment of interest on any covered mortgage obligation,
- (3) any payment on any covered rent obligation, and
- (4) any covered utility payment.

The amount of PPP loan forgiveness received by the recipient company was specifically exempted from being treated as taxable income for federal tax purposes. (taxability for state income tax purposes awaits specific state guidance). (As a reminder, we have made available on our website www.g3cpa.com a downloadable excel based loan forgiveness calculator to assist you in computing the amount of your eligible PPP loan forgiveness and in identifying, tracking and accumulating qualifying expenses.)

Last night's (April 30, 2020) IRS Notice 2020-32 clarifies that no deduction is allowed under the Internal Revenue Code for an expense that is otherwise deductible if the payment of the expense results in forgiveness of a PPP covered loan pursuant to section 1106(b) of the CARES Act and the income associated with the forgiveness is excluded from gross income for federal income tax purposes.

The IRS has invoked Section 265(a)(1) of the Code which applies to otherwise deductible expenses incurred for the purpose of earning or otherwise producing tax-exempt income. It also applies where tax exempt income is earmarked for a specific purpose and deductions are incurred in carrying out that purpose. Both of these situations would appear to relate to expenses utilized to obtain PPP loan forgiveness. Receiving the loan proceeds tax free and being able to deduct the expenses qualifying the loan proceeds as non-taxable has been identified by the IRS as a "double-dip". Whether or not it was Congress' intention that small businesses receive this double-dip benefit to provide additional funding for the company to restart or continue operations after the lockdown so many are experiencing will require further clarification and legislation by Congress and approval by President Trump.

If you have any questions about this or other PPP issues, as always, please contact the Gold Gerstein Group LLC partner or staff member with whom you work. Due to remote operations, it may be most efficient to contact us by email.

This information has been provided by Gold Gerstein Group, LLC.

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