

**PPP LOAN FORGIVENESS TAX ALERT**  
**JULY 21, 2020**

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In response to the COVID-19 Pandemic, the CARES Act was passed by Congress and signed into law by the President. This alert pertains to the Paycheck Protection Program (“PPP”) loan and the ability to have some or all of the loan proceeds forgiven. Most notable of the PPP loan is that the entirety of the loan is eligible for forgiveness if properly used within the covered period, and any amounts forgiven will not be included in gross income for the business. However, in discussions concerning the PPP loan forgiveness with business owners, clients, and colleagues, it has come to our attention that many are aware of the forgiveness potential but most appear to be unaware of the position the IRS has adopted with regards to the deductibility of expenses which were paid from loan proceeds.

In Notice 2020-32,<sup>1</sup> the IRS issued guidance on the deductibility of expenses incurred in a trade or business when such taxpayer has received a loan pursuant to the Paycheck Protection Program. In essence, the notice provided that in the view of the IRS, no deduction is allowed for any expense that would otherwise be deductible, if such expense was paid with PPP loan proceeds to the extent of the loan forgiveness granted pursuant to the CARES Act. This a significant change and incredibly important for tax planning purposes. In taking its non-deductible position, the IRS has created a potential unanticipated tax issue for the borrowers. This is despite the specific language of the CARES Act which provides that the cancellation of the loan would not be included in gross income for the borrower. Here is an illustration that shows the impact:

Company XYZ has revenue of \$400,000 and deductible business expenses of \$400,000. XYZ received a PPP loan of \$100,000 and spent the entire loan on permissible expenditures resulting in 100% forgiveness of the loan. Not accounting for the loan, XYZ would not have owed any taxes because all of its revenue would be offset by deductible business expenses. However, because of the IRS position in Notice 2020-32, XYZ would now only have \$300,000<sup>2</sup> in deductible business expenses resulting in a \$100,000 profit subject to income tax. The net effect results in taxation of the PPP loan amount that was forgiven. If company XYZ was taxed as a partnership or S Corp with 4 total equal owners, then each owner’s K-1 would reflect an additional \$25,000 of which he or she would be responsible for paying employment tax, if applicable, and income tax thereon.

This alert is not intended as tax advice nor to argue the merits of the position of the IRS but merely to make businesses aware of the potential tax issue. Treasury Secretary Mnuchin appears to have agreed with the IRS interpretation. However, certain members of Congress have openly disagreed with the IRS, stating that the intended purpose under the loan program was to continue to allow business deductions. Hopefully, the IRS will recede from this position or Congress will take action to unambiguously provide that expenses paid, even those from PPP Loan funds, are fully deductible if it would otherwise be proper. It will be important for businesses to continue to monitor this issue and consult with their tax advisors and attorneys, as this alert is not a substitute for either, regarding their specific situation to ensure proper tax treatment.<sup>3</sup>

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<sup>1</sup> For a more detailed analysis of Notice 2020-32, please see *IRS says PPP expenses nondeductible, but AICPA disagrees*, The Tax Advisor, by Sally P. Schreiber (<https://www.thetaxadviser.com/issues/2020/jul/irs-ppp-expenses-nondeductible-aicpa-disagrees-coronavirus.html>)

<sup>2</sup> \$400,000 business expenses - \$100,000 PPP loan forgiven = \$300,000 remaining deductible expenses.

<sup>3</sup> Absent a change, businesses will need to consider filing a return applying the IRS guidance to avoid any interest and penalties, and then file for a refund and litigate the issue as an overreach of the IRS in its interpretation.