

CORONAVIRUS

MAY 5, 2020 • NO. 8

IRS Issues Guidance on Deductibility of Expenses Paid with Proceeds of a Forgiven Loan in Connection with Paycheck Protection Program

On April 30, 2020, the Internal Revenue Service (“IRS”) published Notice 2020-32, which provides that no deduction is allowed for federal income tax purposes for an expense that is otherwise deductible if the payment of the expense results in forgiveness of a loan that was offered under the Paycheck Protection Program (“PPP”).

The CARES Act, which established the PPP to incentivize employers to retain employees during the pandemic, provides that loans issued pursuant to the PPP can be forgiven in an amount equal to the sum of payments during a specified period if such payments are for the following expenses: (1) payroll costs, (2) interest on mortgage obligations, (3) rent, and (4) utilities. The amount of loan forgiveness is reduced if, over a specified period, the amount of full-time employees or salaries or wages are reduced. Accordingly, forgiveness of a PPP loan results in a discharge of indebtedness, which is generally categorized as gross income.

The CARES Act addressed the federal income tax consequences resulting from loan forgiveness, and thus a discharge of indebtedness, in connection with a PPP loan. Any amount that would have been included in gross income by a taxpayer for a loan received pursuant to the PPP is excluded from gross income if such loan is forgiven. The CARES Act was silent regarding deductions for expenses paid in connection with forgiven loans received from the PPP.

Generally, taxpayers can deduct all ordinary and necessary business expenses for federal income tax purposes. However, no deduction is allowed for an amount that is otherwise deductible if the expense is allocable to tax-exempt income. Proceeds received under the PPP are required to cover certain ordinary and necessary business expenses as described above. These expenses are allocable to the proceeds of a loan furnished under the PPP, which if used properly, is ultimately forgiven and exempt from federal income tax. Consistent with this purpose, to the extent the CARES Act excludes from gross income a covered loan received under the PPP, no deduction is allowed for payment of such ordinary and necessary business expenses in connection with such loan.

Blank Rome’s [Coronavirus Task Force](#) is continuing to monitor this crisis and will provide further updates for taxpayers as they become available.

For additional information, please contact:

Cory G. Jacobs, Philadelphia Office
Partner and Co-Chair, Tax, Benefits, and Private Client
215.569.5481 | cjacobs@blankrome.com

Joseph T. Gulant, New York Office
Partner and Co-Chair, Business Department
212.885.5304 | jgulant@blankrome.com