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Q&A: Are PPP Loan Forgiveness Expenses Deductible?

Question

If I obtain Paycheck Protection Program (PPP) loan forgiveness, can I still deduct the business expenses I paid with the loan forgiveness proceeds?

Answer

We have bad news—the IRS just released Notice 2020-32 telling us the answer is no.

Quick Review

As we discuss in COVID-19: New SBA Loans for Small Businesses – Maybe a Great Deal:

- Your maximum PPP loan amount is 250 percent of your average monthly payroll expenses, up to \$10 million.
- PPP loan amounts used for payroll, mortgage interest, rent, and utility payments during the eight-week period starting with the loan origination date will be forgiven and excluded from your taxable income.

IRS Position

The IRS says the payments you make during that eight-week period to get the non-taxable loan forgiveness are non-deductible up to the aggregate amount forgiven, for two reasons:

1. The payments are allocable to tax-exempt income, making them non-deductible.
2. Deductions for otherwise deductible payments are non-deductible if you receive a reimbursement for those payments.

Neither the CARES Act nor the Joint Committee on Taxation's explanation of the CARES Act addresses the deductibility issue.

Takeaways

The IRS says you can't take a tax deduction for the business expenses you used to qualify for PPP loan forgiveness.

The key benefit of the PPP loan is that you can have the loan forgiven—essentially putting free cash in your pocket.

Your inability to deduct the expenses that created that non-taxable loan forgiveness takes away some cash due to loss of tax deductions, but you are still well ahead with the PPP loan from a cash-in-hand perspective.

This IRS position generates at least one question we'll need to answer in the coming weeks or months: does this affect the wage amount you use to calculate your Section 199A deduction if you are over the Section 199A taxable income threshold?

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