

## NEWS ALERT

# TAX AND BUSINESS GROUPS



### IRS Denies Deduction of Qualifying PPP Loan Expenses If Taxpayer Reasonably Expects Loan Forgiveness

By Marc T. Finer | November 23, 2020

In May 2020, the IRS issued [Notice 2020-32](#) which addressed the deductibility of qualifying expenses (i.e., payroll costs, mortgage interest, rent and utilities) in the context of a loan covered under the Paycheck Protection Program (“PPP”). The Notice clarified that no deduction is allowed for an expense that is otherwise deductible if the payment of the expense results in forgiveness of the covered loan and the income associated with the forgiveness is excluded from gross income pursuant to the PPP. Many tax professionals have suggested that the “results in forgiveness of the covered loan” phrase in the Notice implied that actual forgiveness needed to occur before the qualifying expenses became nondeductible. On that basis, some PPP borrowers were advised to deduct qualifying expenses in the year the expenses were paid or incurred if they did not receive a decision regarding forgiveness or did not apply for forgiveness before the end of that same year.

On November 18, 2020, the IRS released [Rev. Rul. 2020-27](#) which confirms that a taxpayer who received a PPP loan and paid or incurred otherwise deductible qualifying expenses may not deduct those expenses in the tax year in which the expenses were paid or incurred if, at the end of that tax year, the taxpayer “reasonably expects” to receive forgiveness of the loan, even if the taxpayer has not submitted a forgiveness application by the end of that tax year. Unfortunately, Rev. Rul. 2020-27 does not provide guidance as to the “reasonably expects” standard. The ruling provides two scenarios to illustrate the IRS’s position. In both examples, the taxpayer receives a PPP loan in 2020, uses the loan to pay for qualifying expenses, and otherwise satisfies all of the other requirements for its PPP loan to be forgiven. In the first scenario, the taxpayer applies for forgiveness in November 2020 and in the second scenario, the taxpayer expects to apply for forgiveness in 2021. The Notice concludes that the taxpayer in both scenarios is not permitted to deduct the qualifying expenses because the taxpayer has a reasonable expectation of forgiveness.

In conjunction with Rev. Rul. 2020-27, the IRS also released [Rev. Proc. 2020-51](#) which provides two safe harbor options for allowing a taxpayer who receives a PPP loan to deduct the qualifying expenses if:

- The qualifying expenses are paid or incurred during the 2020 tax year;
- The taxpayer receives a PPP loan which, at the end of the 2020 tax year, the taxpayer expects to be forgiven in a tax year after 2020; and
- In a subsequent tax year, the taxpayer’s request for forgiveness is partially or entirely denied or the taxpayer decides to never request forgiveness of the PPP loan.

Under the two safe harbor options, the taxpayer can deduct the qualifying expenses:

- 1) on a timely filed (including extensions) original income tax or information return, as applicable, or amended tax return for the 2020 tax year; or
- 2) on a timely filed (including extensions) original income tax or information return, as applicable, for the subsequent tax year (i.e., 2021 tax year).

Taxpayers choosing to take advantage of the safe harbor procedures must include a statement with the relevant return to provide certain details regarding their PPP loan, the amount of qualifying expenses and the circumstances under which the loan was not forgiven (i.e., denial or decision not to apply for forgiveness). A taxpayer may not deduct an amount of non-deducted eligible expenses in excess of the principal amount of the taxpayer's PPP loan for which forgiveness was denied or will no longer be sought.

The issuance of Rev. Rul. 2020-32 provides important guidance to taxpayers who were waiting to file their PPP loan forgiveness application until the 2021 tax year to secure deductions for qualifying expenses in the 2020 tax year. The guidance is also important to taxpayers who filed a forgiveness application but were unclear about how to file their 2020 tax return. However, further questions still remain including the factors a taxpayer should apply to determine whether the "reasonable expectation of forgiveness" standard has been satisfied, as noted above. In addition, it is possible that bipartisan legislation by a new president and a new Congress will reverse the IRS's position regarding the non-deductibility of qualifying expenses for taxpayers that receive forgiveness of their PPP loan.

*If you have any questions regarding Rev. Rul. 2020-32 or Rev. Proc. 2020-51 or how to navigate the PPP loan forgiveness process, please contact:*

*Connecticut: Marc T. Finer, Tax & Corporate Partner, at 860-240-6096 or [mfiner@murthlaw.com](mailto:mfiner@murthlaw.com)*

*Massachusetts: Mark J. Tarallo, Corporate Partner, at 617-457-4059 or [mtarallo@murthlaw.com](mailto:mtarallo@murthlaw.com)*

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