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IRS Doubles Down on No Double Dip

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EXECUTIVE SUMMARY

Companies that receive or are reasonably expected to receive forgiveness for Paycheck Protection Program (“PPP”) loans cannot deduct expenses for payroll costs, interest on covered mortgage obligation, rent or utilities (“CARES Act Expenses”) for which they used PPP loan funds. This position was first published by the Internal Revenue Service (“IRS”) in Notice 2020-32 in May 2020. The IRS issued Revenue Rule 2020-27 and Revenue Procedure 2020-51 on November 18, 2020 (“Recent Guidance”) to amplify its position in Notice 2020-32.

However, the Recent Guidance does not clarify if CARES Act Expenses can be deducted for tax purposes when PPP loan funds were not used in part or full to pay such expenses or how to allocate deductions if full forgiveness is not received. Thus, further clarification is needed unless Congress passes legislation to overturn the IRS’ position.

In May 2020, the Department of the Treasury and IRS released Notice 2020-32, 2020-21 IRB 837 (“Notice 2020-32”) that stated that no tax deduction was allowed for CARES Act Expenses if payment of the CARES Act Expense results in forgiveness of the PPP loan. This is because the IRS position is that Section 1106(i) of the CARES Act specifically excluded forgiven PPP loan amounts from gross income and takes the position that allowing deductions for CARES Act Expenses would be a double tax benefit or double dip.

On November 18, 2020, the IRS issued Revenue Rule 2020-27 (“Rev. Rule”) and Revenue Procedure 2020-51 (“Rev. Proc.”) to amplify its position in Notice 2020-32. Thus, as of now, companies that received or are reasonably expected to receive forgiveness for PPP loans cannot deduct CARES Act Expenses in their 2020 tax return. This applies even if an application for PPP loan forgiveness is not yet filed or is filed in 2021. The Rev. Proc. does not clarify if CARES Act Expenses can be deducted for tax purposes when PPP loan funds were not used in part or full to pay such expenses or how to allocate deductions if full forgiveness is not received. Thus, further clarification is needed.

Rev. Proc. provides a safe harbor rule for companies that are denied PPP loan forgiveness (in full or in part) or decide not to seek forgiveness to deduct CARES Act Expenses in their originally filed 2020 tax return, an amended 2020 tax return or through an administrative adjustment request, or 2021 tax return. The safe harbor is only available if a specific “Revenue Procedure 2020-51 Statement” is attached to the applicable tax return.

The CARES Act does not specifically address whether PPP loan recipients are allowed to deduct CARES Act Expenses if the PPP loan is subsequently forgiven. Section 1106(i) of the CARES Act did specifically provide that forgiven PPP loan amounts were not includable in gross income. When Notice 2020-32 was originally issued, members of Congress disagreed with the IRS position. In addition, Senate Finance Committee Chairman Chuck Grassley (R-Iowa) and member Ron Wyden (D-Ore) issued a joint statement on November 19, 2020 reiterating the intent of the CARES Act was to permit deductions for “ordinary and necessary business expenses.” Thus, with bi-partisan support of Congress, legislation could be passed to overturn the IRS position.

Please contact Jennifer R. Watson or a member of the Corporate, Finance or Acquisition Group with any questions regarding PPP loans.