

Can I Deduct Expenses Paid with a PPP Loan?

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In recently released [Revenue Ruling 2020-27](#), the IRS addressed the following two fact patterns:

- First, Maria received a PPP loan in 2020 that she used to pay “Covered Expenses.” Maria meets the requirements for forgiveness of the PPP loan and she files the application for forgiveness in 2020. Maria reasonably expects her PPP loan to be forgiven when she files the application. The IRS says Maria cannot deduct the Covered Expenses she paid or incurred in 2020 on her 2020 income tax return, regardless of whether or not she receives notice from the lender before the end of the year that the loan has been forgiven.
- Next, Alexandria, like Maria, received a PPP loan in 2020 that she used to pay Covered Expenses. Unlike Maria, Alexandria decides she will wait and file an application for forgiveness of the PPP loan in 2021. Alexandria reasonably believes at the end of 2020 that the loan will eventually be forgiven. Because Alexandria reasonably believes her PPP loan will be forgiven, albeit in 2021, the IRS says Alexandria cannot deduct in 2020 the Covered Expenses she paid in 2020.

(In [IRS Notice 2020-32](#), released May 2, 2020, the IRS clarified that no deduction is allowed for a Covered Expense that is otherwise deductible if the payment of the eligible expense results in forgiveness of a PPP loan. Revenue Ruling 2020-27 expands upon this Notice.)

As set forth in the two fact patterns, the IRS has now ruled that **no deduction is allowed in either situation** because each taxpayer reasonably expects that she will be reimbursed (via forgiveness of the PPP loan) for the Covered Expenses paid or incurred. The fact that Alexandria will not file her application for loan forgiveness until 2021 is irrelevant.

But, to add a third fact pattern, what about Ana? Like Maria and Alexandria, Ana received a PPP loan in 2020 that she used to pay Covered Expenses. Unlike Maria and Alexandria, Ana decides she will **never file an application for forgiveness** of the PPP loan even though she satisfies all the conditions for forgiveness. Under recently released [Revenue Procedure 2020-51](#), the IRS provides a safe harbor that allows Ana to deduct the Covered Expenses. While it makes sense that Ana should be entitled to deduct Covered Expenses if her PPP loan will not be forgiven, why was it necessary for IRS to provide guidance?

Covered Expenses

For a PPP loan to be eligible for forgiveness, it must be used to pay for “Covered Expenses” during the “Covered Period.” Covered Expenses are: (1) payroll costs, (2) interest on a covered mortgage obligation, (3) any covered

rent obligation payment, and (4) any covered utility payment. The Covered Period during which Covered Expenses must be paid or incurred is the period beginning on February 15, 2020 and ending on December 31, 2020.

Covered Expenses are the type of expenses that are generally deductible. The Internal Revenue Code (Code) and regulations thereunder have long held, however, that no deduction is allowed for any amount otherwise allowable as a deduction to the extent the amount is allocable to one or more “classes of exempt income.” The term “class of exempt income” generally means any class of income that is either wholly excluded from gross income or wholly exempt from taxes. This rule applies whether or not any amount of income of that class or classes is actually received or accrued. In addition, case law has long held that deductions for otherwise deductible expenses are disallowed if the taxpayer receives reimbursement for such expenses.

CARES Act and PPP Loans

Generally, income includes any amount of debt that is forgiven, but the CARES Act provides that “any amount which . . . would be includible in gross income of the eligible recipient by reason of forgiveness [of a PPP loan] . . . shall be excluded from gross income”. Section 1106(i) of the CARES Act excludes the forgiven amounts from gross income regardless of whether the income would be (1) income from the discharge of indebtedness under section 61(a)(11) of the Code, or (2) otherwise includible in gross income under section 61 of the Code.

Because a PPP loan can be forgiven (provided it is used to pay Covered Expenses during the Covered Period) and there is no income from the forgiveness of a PPP loan, any expenses paid with a PPP loan are allocable to a class of income that is exempt from income taxes. Under the general rule that denies a deduction for expenses allocable to tax-exempt income, it does not matter whether or not the PPP loan is forgiven. Thus, under the general rule, Ana arguably would not be entitled to deduct the Covered Expenses even though she chooses not to seek forgiveness of the PPP loan.

This, to most people, would be deemed an unfair result for Ana, i.e., Ana must repay the PPP loan but she cannot deduct the Covered Expenses. Revenue Procedure 2020-51 clarifies the rules for PPP loan recipients who are either denied forgiveness of the PPP loan or choose not to seek forgiveness. It provides a **safe harbor allowing a taxpayer to claim a deduction** in the taxpayer’s taxable year beginning or ending in 2020 (2020 taxable year) for Covered Expenses, if (1) (i) the Covered Expenses are paid or incurred during the taxpayer’s 2020 taxable year, (ii) the taxpayer receives PPP loan, which at the end of the taxpayer’s 2020 taxable year the taxpayer expects to be forgiven in a taxable year after the 2020 taxable year (subsequent taxable year), and (iii) in a subsequent taxable year, the taxpayer’s request for forgiveness of the covered loan is denied, in whole or in part; or (2) the requirements of (i) and (ii) above are met but the taxpayer decides never to request forgiveness of the covered loan. A taxpayer who meets one of the safe harbor requirements may be able to deduct some or all of the Covered Expenses on (1) the taxpayer’s timely filed, including extensions, original income tax return or information return, as applicable, for the 2020 taxable year; (2) an amended return or an administrative adjustment request under section 6227 of the Code for the 2020 taxable year, as applicable; or (3) the taxpayer’s timely filed, including extensions, original income tax return or information return, as applicable, for the subsequent taxable year.

Required Statement

To claim the deduction, a taxpayer must attach a statement to the return on which the taxpayer deducts the Covered Expenses. The statement must be titled “Revenue Procedure 2020-51 Statement,” and must include certain specific information (with cites to provisions of the revenue procedure) set forth in section 4 of the revenue procedure. This information includes:

1. The taxpayer’s name, address, and social security number or employer identification number;
2. A statement specifying whether the taxpayer is an eligible taxpayer because the taxpayer was denied forgiveness of the loan or chose not to seek forgiveness;
3. A statement that the taxpayer is claiming the deduction in 2020 or a subsequent taxable year;
4. The amount and date of disbursement of the PPP loan;
5. The total amount of PPP loan forgiveness that the taxpayer was denied or decided to no longer seek;
6. The date the taxpayer was denied or decided to no longer seek PPP loan forgiveness; and
7. The total amount of Covered Expenses and non-deducted Covered Expenses that are reported on the return.

Safe Harbor Benefits

The safe harbor provides two benefits. First, it allows a deduction for taxpayers who are **eligible for forgiveness but choose not to seek it**. Thus, Ana will be entitled to deduct her Covered Expenses. Second, it gives taxpayers who choose not to seek forgiveness or whose loans are partially or fully not forgiven the **ability to claim a deduction** in 2020 or a subsequent year for the Covered Expenses even though the decision not to seek forgiveness or the denial of forgiveness occurs after 2020. This can accelerate into 2020 a deduction that might not otherwise be eligible until a later taxable year under general tax principals. It is reasonable to expect that most taxpayers will choose to seek forgiveness of the PPP loan rather than claiming a deduction for the Covered Expenses. For the taxpayer who does choose to forego forgiveness and deduct the Covered Expenses, being able to claim the deduction in 2020 rather than a later year might have a tax benefit. Net operating losses (NOLs) incurred in 2020 can be carried back five years. While NOLs incurred after 2020 only can be carried forward. Moreover, NOLs carried back from 2020 are not subject to the 80-percent limitation on NOL carryforwards.

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