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## Some Expenses May No Longer Be Deductible In Connection With PPP Loans

On April 30, the Internal Revenue Service (“IRS”) released Notice 2020-32 clarifying the IRS’s position with respect to the deductibility of certain expenses paid using loan proceeds received under the CARES Act’s Paycheck Protection Program (“PPP”). The recent IRS Notice confirms that no deductions will be permitted for otherwise deductible expenses to the extent such expenses are paid utilizing PPP loan proceeds that are ultimately forgiven and excluded from gross income under Section 1106(i) of the CARES Act.

Under Section 1106(b) of the CARES Act, a recipient of a covered PPP loan can receive forgiveness of indebtedness on the loan amount equal to the sum of “costs incurred and payments made” for the following expenses during the 8-week period beginning on the loan’s origination date (subject to certain exclusions and reductions): (1) payroll costs, (2) interest on any covered mortgage obligation, (3) covered rent obligations, and (4) covered utility payments. Furthermore, Section 1106(i) of the CARES Act excludes from the recipient taxpayer’s gross income any income that may arise from the PPP loan forgiveness. This exclusion from gross income provides a significant benefit to PPP loan recipients as cancellation of a debt is generally included in the recipient taxpayer’s gross income.

The text of the CARES Act, however, failed to address the deductibility of expenses paid using ultimately forgiven PPP loan funds when such expenses are otherwise deductible under the Internal Revenue Code (the “Code”). Specifically, Code § 162 provides for a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Code § 163 provides for a deduction for certain interest paid or accrued on indebtedness, including interest paid or incurred on a mortgage obligation of a trade or business. Payroll costs, mortgage and rent obligations, and utility costs are therefore typically deductible under Code § 162 and § 163.

Relying on Code § 265, the IRS has taken the position in the Notice that allowing deductions for such expenses would amount to a “double tax benefit.” Code § 265(a)(1) provides that no deduction is permitted for an otherwise deductible amount to the extent such deduction is allocable to income excluded from the calculation of gross income. Therefore, the IRS has confirmed its position that, in accordance with Code § 265, no deductions are allowed to the extent otherwise deductible expenses are paid using PPP loan proceeds that are ultimately forgiven and excluded from gross income.

Even though the Notice is less than a week old as of the date of this Client Alert, there has already been significant opposition to the IRS’s position. Many commentators have noted that the benefit

provided by the CARES Act by way of excluding the forgiven PPP loan amount from gross income is effectively reversed or significantly mitigated by the IRS's disallowance of a deduction for these trade or business expenses paid using proceeds from the PPP loan. Since the publication of the Notice, the Senate Finance Committee Chairman and the House Ways and Means Committee Chairman have both voiced opposition to the guidance, noting that the Notice is contrary to the intent and policy of the Paycheck Protection Program. However, Treasury Secretary Steve Mnuchin has publicly supported the IRS's position. Given that the CARES Act is silent on this issue, it is possible we will see further action from Congress to address the IRS's position in the coming weeks.

Please reach out to a member of Maynard Cooper's [Tax Practice](#) if you have any questions or need assistance with your tax related COVID-19 concerns.

Maynard Cooper's [COVID-19 Coronavirus Task Force](#) is closely monitoring all updates to pending legislation related to the COVID-19 pandemic. We are dedicated to providing client-focused services, and it is the goal of the Task Force to continue this level of service to each and every client as they face challenges about planning for and responding to the threats posed by the virus. If you have any questions, please reach out to your relationship partner or any of the attorneys serving on the Task Force.

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