Shavell & Company, P.A.
Certified Public Accountants and Consultants

Memo

To: Clients & Friends

From: Rich Shavell, CPA, CVA, CCIFP

Date: November 19, 2020

Re: **IRS Clarifies that PPP Expenditures are not Deductible**

Yesterday, IRS released Revenue Ruling 2020-27, which clarifies that a business whose Paycheck Protection Program ("PPP") loan has yet to be forgiven, **CANNOT** deduct the PPP funded expenditures ***in the year paid.*** That means that the PPP funded 2020 expenditures will need to be added back (not-deductible) on your 2020 tax return if you have a "reasonable expectation of forgiveness."

This will impact your 2020 year-end tax projections and eventual liability.

Until the IRS released Revenue Ruling 2020-27, many tax practitioners believed that businesses that had not yet received PPP loan forgiveness could deduct the related expenses in 2020, thereby deferring any potential tax impact until the year of loan forgiveness, i.e. 2021. A Treasury Department statement related to Rev. Rul. 2020-27 clarifies: "If a business reasonably believes that a PPP loan will be forgiven in the future, expenses related to the loan are not deductible, whether the business has filed for forgiveness or not."

This issue is still not completely resolved as Congress may still act and resolve the discrepancy. Earlier this year, immediately after IRS took the position that the expenditures are not deductible, there has been continuous bi-partisan support that IRS should not be taking this position because this was not the intent of Congress. Now we wait for Congress to act.

Below is an article on the subject published on TaxNotes.com:

IRS Drops Another Hammer on PPP-Funded Deduction

POSTED ON NOV. 19, 2020
By ERIC YAUCH

The IRS has confirmed practitioners' fears and clarified that if expenses are funded with a Paycheck Protection Program loan that hasn't yet been forgiven, that doesn't mean they can take the deductions this year.

"If a business reasonably believes that a PPP loan will be forgiven in the future, expenses related to the loan are not deductible, whether the business has filed for forgiveness or not. Therefore, we encourage businesses to file for forgiveness as soon as possible," said a Treasury statement.

The IRS released Rev. Rul. 2020-27, 2020-50 IRB 1, November 18 after practitioners speculated for weeks as to whether the government would actually rule on the matter. The PPP was created by the Coronavirus Aid, Relief, and Economic Security Act (P.L. 116-136), which was enacted in March and provides loans that can be forgiven tax free if portions of the proceeds are spent on items such as payroll.

Immediately after the PPP was created, practitioners noted that it wasn't clear whether expenses funded with PPP loans would be deductible if the loans were forgiven, but the IRS quickly issued Notice 2020-32, 2020-21 IRB 837, in response. According to that notice, the expenses funded with the forgiven PPP loans weren't deductible, to avoid a double tax benefit.

But some practitioners said it was still unclear what would happen when expenses were funded with PPP loans that wouldn't be forgiven until a later year. Rumors spread that the IRS planned to issue guidance on the issue stating that if a borrower reasonably expected to have the loan forgiven because it met the various Treasury and Small Business Administration criteria, the expenses still couldn't be deducted if the loan was on the books at the end of the year.

In Rev. Rul. 2020-27, the IRS confirmed the rumors were true.

The IRS laid out two scenarios in the revenue ruling. In scenario one, a borrower pays expenses such as payroll and mortgage interest that qualify under the CARES Act as valid PPP expenditures. In that scenario, the borrower applies for forgiveness in November 2020 and satisfies all the requirements under the CARES Act to have the loan forgiven, but it doesn't yet have an answer as to whether it will be forgiven.

In scenario two, the borrower pays the same type of valid expenses with its PPP loan and satisfies the CARES Act requirements for the loan, but it expects to apply for forgiveness in 2021.
According to the IRS, the businesses in both scenarios can't deduct expenses funded with PPP loans because they have a reasonable expectation of forgiveness.

“A taxpayer that received a covered loan guaranteed under the PPP and paid or incurred certain otherwise deductible expenses listed in section 1106(b) of the CARES Act may not deduct those expenses in the taxable year in which the expenses were paid or incurred if, at the end of such taxable year, the taxpayer reasonably expects to receive forgiveness of the covered loan on the basis of the expenses it paid or accrued during the covered period, even if the taxpayer has not submitted an application for forgiveness of the covered loan by the end of such taxable year,” the government concluded.

The IRS also released Rev. Proc. 2020-51, 2020-50 IRB 1, which provides a safe harbor for PPP borrowers whose loan forgiveness has been partially or fully denied and who wish to claim deductions for otherwise eligible payments on a return, amended return, or administrative adjustment request.