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## IRS Disallows Deductions Funded with PPP Loans that are Expected to be Forgiven

By [Ivan H. Golden](#)

The Internal Revenue Service (“*IRS*”) ruled on November 18 that taxpayers that received Paycheck Protection Program (“*PPP*”) loans and used the proceeds to pay otherwise-deductible expenses may not deduct the payments if the taxpayer reasonably expects to receive forgiveness of the PPP loan.

Although the *IRS*'s ruling is not as generous as some businesses and tax practitioners had hoped, it does provide some measure of certainty as businesses look toward forgiveness of their PPP loans, the end of the calendar year, and the preparation of their 2020 tax returns.

The PPP, a pillar of the Coronavirus Aid, Relief, and Economic Security Act, provided low-interest loans of up to \$10 million to small- and medium-sized businesses to help them maintain their payrolls and weather the economic disruption caused by COVID-19. Businesses are eligible for forgiveness of PPP loans – and the forgiveness is excluded from gross income – to the extent proceeds are used for payroll, rent, mortgage interest, and utilities – making the loans effectively equivalent to tax-free grants.

The *IRS* previously ruled that no deduction is allowed for the payment of an otherwise-deductible expense if the payment results in forgiveness of a PPP loan. See *IRS Notice 2020-32, 2020-21 IRB 837 (May 18, 2020)*. Notice 2020-32 left businesses and tax practitioners uncertain how to treat deductible expenses paid or incurred in 2020, where the business had not yet received or even applied for forgiveness by the end of 2020.

The latest *IRS* guidance offers two examples: In the first, a calendar-year taxpayer receives a PPP loan and uses the proceeds to pay otherwise deductible expenses in 2020. The taxpayer applies for forgiveness of its PPP loan in November 2020 but does not receive a decision from its lender before the end of the year. In the second example, the facts are the same, except the taxpayer does not even apply for loan forgiveness before the end of 2020, though taxpayer expects it will apply for and receive forgiveness of its PPP loan in 2021.

In both examples, the *IRS* ruled, the taxpayer cannot deduct otherwise-deductible expenses paid or incurred in 2020 and funded with PPP loan proceeds because the taxpayer reasonably expects the amounts will be forgiven. The *IRS* ruling is based on authorities holding that a taxpayer cannot deduct otherwise-deductible expenses if the taxpayer receives, or reasonably expects to receive, reimbursement for the expenses.

As noted above, although the *IRS*'s ruling is perhaps not as generous as some taxpayers and advisors had hoped, it at least gives taxpayers certainty of the proper tax treatment of expenses funded with PPP loan proceeds.

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The IRS's ruling is Rev. Rul. 2020-27, available at <https://www.irs.gov/pub/irs-drop/rr-20-27.pdf>.

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