

IRS Disallows Deduction For Allowable PPP Expenses

On April 30, 2020, the IRS released IRS Notice 2020-32 addressing the deductibility of expenses for which a Paycheck Protection Program (PPP) loan borrower is granted PPP loan forgiveness.

For the eight week period after the disbursement of a PPP loan, a borrower can use (and potentially receive forgiveness of) its PPP loan for payments of covered payroll costs, interest on covered mortgage obligations, payment of covered rent, and payment of covered utility payments. The CARES Act specifies that any amount of a PPP loan that is forgiven is excluded from gross income. The Act is silent on whether borrowers may deduct the expenses paid with loan proceeds that are forgiven.

Section 162 of the Internal Revenue Code (Code) generally provides a deduction for all ordinary and necessary expenses paid or incurred in carrying on a trade or business. Section 163 provides a deduction for certain interest paid or accrued during the taxable year on indebtedness. The PPP loan forgiveness expenses generally fall within Sections 162 and 163.

However, Code Section 265 and its regulations do not allow a deduction "for any amount otherwise allowable as a deduction to such taxpayer that is allocable to one or more classes of income other than interest (whether or not any amount of income of that class or classes is received or accrued) wholly exempt from the taxes imposed by subtitle A of the Code." The purpose of Section 265 is to prevent a double tax benefit. As such, Section 265 applies to otherwise deductible expenses incurred for the purpose of earning income which is not taxed.

Thus, to the extent that the CARES Act operates to exclude from gross income the amount of a covered loan forgiven, that results in a "class of exempt income", and accordingly, Section 265 of the Code disallows any otherwise allowable deduction under Sections 162 and 1623 for the amount of any payment to the extent of resulting loan forgiveness. The IRS position is that this result is consistent with the purpose of Section 265, which prevents a double tax benefit.

[You can read Notice 2020-32 here.](#)

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