

Expenses Paid with PPP Loan Proceeds Are Not Deductible

On November 18, 2020, the Internal Revenue Service issued Revenue Ruling 2020-27, and confirmed its earlier guidance that expenses funded with the proceeds of a Paycheck Protection Program (“PPP”) loan are not deductible. The IRS also issued Revenue Procedure 2020-51, which identified a safe harbor for PPP borrowers.

Typically, cancelled or forgiven loans result in taxable ordinary income to the borrower in the amount of remaining loan principal. However, under the CARES Act, signed into law by President Trump on March 27, 2020, PPP loan proceeds are not taxable income if the loan is subsequently forgiven. In last week’s ruling, the IRS concluded that if the PPP loan proceeds are used during the “covered period” for “eligible expenses” (i.e. payroll, rent, mortgage interest and utilities), a borrower cannot exclude the loan proceeds from income and deduct business expenses paid with such proceeds. Instead, a borrower is entitled to only one benefit. If the loan proceeds are not taxable income, expenses paid are not deductible. Alternatively, if PPP loan proceeds are included as income, expenses paid with the proceeds are deductible.

Under this ruling, so long as there is a reasonable expectation that a PPP loan will be forgiven

under the CARES Act, a borrower cannot deduct expenses when they are paid. This is true even if the application for forgiveness is submitted in 2021, or the SBA acts on the forgiveness application in 2021. The IRS defines “reasonable expectation” as the borrower (i) having satisfied the requirements for forgiveness, and (ii) expecting to apply for forgiveness.

In conjunction with this ruling, the IRS also issued Revenue Procedure 2020-51, which creates a safe harbor for PPP borrowers. If a PPP borrower expects its loan to be forgiven, but ultimately its loan forgiveness application is denied (in whole or in part) or the borrower decides not to submit a forgiveness application, expenses paid with the PPP loan proceeds are deductible. Taxpayers eligible for this safe harbor can claim such deductions on a timely filed 2020 tax return, an amended 2020 tax return, or a timely filed tax return for the subsequent year. The Revenue Procedure also includes detailed filing instructions for affected taxpayers, which include filing a statement specifying eligibility with the safe harbor, details of the PPP loan, factual background regarding the denial of forgiveness or decision to forego the application, and other information.

This advisory is for information purposes only, and does not constitute legal advice. If you would like to discuss the impact of the CARES Act on you or your business, please contact Joe LaFerrera, Aaron Kriss, or Sean Gilligan at (617) 350-6800, or email them at joe.laferrera@gesmer.com, aaron.kriss@gesmer.com, or sean.gilligan@gesmer.com.



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