



IRS Issues New Guidance on Tax Effect of PPP Loan Forgiveness

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The Internal Revenue Service (IRS), has [issued further guidance](#) on federal income tax treatment of loans received and forgiven under the Paycheck Protection Program (“PPP”) established by the CARES Act.

[Revenue Ruling 2020-27](#) amplifies and restates the IRS position that covered expenses paid by a taxpayer with proceeds of a PPP loan are not deductible for federal income tax purposes if the loan is forgiven under PPP and the CARES Act.

[Revenue Procedure 2020-51](#) provides guidance for taxpayers to claim federal income tax deductions for covered expenses paid or accrued in 2020 prior to forgiveness of a PPP covered loan that is reasonably anticipated to occur in the future.

Background

The PPP is designed to assist small businesses nationwide adversely impacted by the COVID-19 emergency to pay payroll costs and other covered expenses. The PPP provides that the Small Business Administration (“SBA”) may guarantee the principal amount of a covered loan made in a limited covered period; and that a covered loan may be forgiven if the amount borrowed is used to pay certain eligible expenses. The covered period is the period beginning on February 15, 2020, and ending on December 31, 2020. The CARES Act and PPP provide that the recipient of covered loan can receive forgiveness of the loan, up to an amount of certain eligible expenses paid or incurred by the recipient during the covered period, such as payroll costs, interest, and rent. The CARES Act further provides that any amount that would otherwise be includible in gross income by reason of forgiveness of a PPP covered loan shall be excluded from the recipient’s gross income for federal income tax purposes. In [Notice 2020-32](#), released May 2, 2020, the IRS gave notice of its interpretation that no deduction is allowed for an eligible expense that is otherwise deductible if the payment of the eligible expense results in forgiveness of a covered loan under the PPP. The IRS stated that under section 265 of the Internal Revenue Code no deduction is allowed for any amount otherwise allowable as a deduction to the extent the amount is allocable to income that is exempt from federal income tax under the Code.

Revenue Ruling 2020-27

In Revenue Ruling 2020-27, the IRS states that it is amplifying its prior stated interpretation in Notice 2020-32 regarding the deduction of expenses incurred for forgiveness of a loan received under the PPP.

The IRS ruling pertains to a taxpayer that has received a loan guaranteed under the PPP and has used it to pay eligible expenses in 2020, but the forgiveness of the loan has not determined, or occurred, by the end of 2020. The issue is whether such a taxpayer may deduct the eligible expenses for the 2020 taxable year in two (2) situations.

In Situation 1, the taxpayer, with a calendar taxable year, incurred covered expenses after receiving a PPP loan. In November of 2020, the taxpayer applied to the lender for forgiveness of the covered loan based on the eligible expenses the taxpayer paid during the covered period. The taxpayer had satisfied requirements for forgiveness of the covered loan, but the lender had not informed the taxpayer whether the covered loan would be forgiven before the end of 2020.

In Situation 2, the same facts exist, except the taxpayer did not apply for forgiveness of the covered loan before the end of 2020. Although, taking into account the taxpayer's payment of the eligible expenses during the covered period, it was recognized that the taxpayer satisfied all other requirements for forgiveness of the covered loan, and the taxpayer expected to apply to the lender for forgiveness of the covered loan in 2021.

The IRS ruled that in both Situation 1 and Situation 2, based on authorities cited in the ruling, that the eligible expenses paid or incurred by the taxpayers are not deductible for the 2020 taxable year because there is a *reasonable expectation of reimbursement* of the expenses in the form of a covered loan forgiveness under PPP. According to the ruling, the fact that the tax exempt income (covered loan forgiveness) may not have been accrued or received by the end of the taxable year does not make expenses deductible because the disallowance applies whether or not any amount of tax-exempt income in the form of covered loan forgiveness to which the eligible expenses are allocable is received or accrued.

Revenue Procedure 2020-51

Revenue Procedure 2020-51 provides IRS guidance on dealing with the effect of its guidance in Revenue Ruling 2020-37 which rules that covered expenses paid in 2020 with PPP covered loan proceeds are not deductible for the 2020 taxable year if in 2020 the taxpayer reasonably expects the loan to be forgiven.

Revenue Procedure 2020-51 provides a "safe harbor" exception from the general that no deduction is allowed of eligible expenses for the 2020 taxable year if the taxpayer at the end of that taxable year reasonably expects covered loan forgiveness. The safe harbor exception allows a taxpayer to claim a deduction for eligible expenses for the taxpayer's 2020 taxable year, even if at the end of the taxpayer's 2020 taxable year the taxpayer reasonably expects its covered PPP loan involved to be forgiven. The safe harbor deduction will be allowed if in a subsequent taxable year (e.g. 2021) either the taxpayer's request for the loan forgiveness of the covered loan is denied, or in a subsequent taxable year, the taxpayer irrevocably decides never to request such forgiveness.

Safe Harbor Deduction - Subsequent Year Denial of Loan Forgiveness

The requirements a taxpayer must meet to come within the safe harbor in order to claim a deduction of covered expenses for the 2020 taxable year when loan forgiveness is denied in a subsequent taxable year are:

- (1) The taxpayer paid or incurred eligible expenses in the 2020 taxable year for which no deduction is permitted, because at the end of the 2020 taxable year, the taxpayer reasonably expects to receive forgiveness of the covered loan based on those eligible expenses (non-deducted eligible expenses);
- (2) The taxpayer submitted before the end of the 2020 taxable year, or (as of the end of the 2020 taxable year) intends to submit an application for covered loan forgiveness to the lender in a subsequent taxable year; and
- (3) In a subsequent taxable year, the lender notifies the taxpayer that forgiveness of all or part of the covered loan is denied.

Safe Harbor Deduction – Subsequent Year Decision Not to Seek Loan Forgiveness

The requirements a taxpayer must meet to come within the safe harbor to claim a deduction of covered expenses for the 2020 taxable year when the taxpayer irrevocably decides in a subsequent taxable year to never request forgiveness of the PPP loan are:

- (1) The taxpayer paid or incurred eligible expenses in the 2020 taxable year for which no deduction is permitted, because at the end of the 2020 taxable year, the taxpayer reasonably expects to receive forgiveness of the covered loan based on those eligible expenses (non-deducted eligible expenses);
- (2) The taxpayer submitted before the end of the 2020 taxable year, or (as of the end of the 2020 taxable year) intends to submit an application for covered loan forgiveness to the lender in a subsequent taxable year; and
- (3) In a subsequent taxable year, the taxpayer irrevocably decides not to seek forgiveness for some or all of the covered PPP loan. For example, a taxpayer determines that it will not qualify for covered loan forgiveness and withdraws the application submitted to the lender.

Safe Harbor Requirements for Deduction for 2020 Taxable Year or Subsequent Taxable Year

Revenue Procedure 2020-51 provides that a taxpayer who meets the safe harbor requirements for deduction of expenses for the 2020 taxable year, as described above, may deduct such expenses (“non-deducted eligible expenses”) on its timely filed tax return for taxable year 2020, or any subsequent taxable year, in accordance with specified requirements.

- (1) Taxpayers who had a covered PPP loan denied may, but do not need to, use the safe harbor to deduct non-deducted eligible expenses in a subsequent taxable year because those taxpayers may deduct the non-deducted eligible expenses in the year

that the loan forgiveness is denied under general tax principles, assuming that the taxpayer does not elect to the use the “safe harbor” of the revenue procedure.

- (2) A taxpayer who does not have a covered PPP loan denied, but elects not to seek forgiveness of such loan, may not deduct an amount of non-deducted eligible expenses in excess of the principal amount of the taxpayer's covered loan for which forgiveness was denied or will no longer be sought.
- (3) A taxpayer may not deduct any amount of non-deducted eligible expenses unless the taxpayer attaches a statement to the tax return on which the taxpayer deducts non-deducted eligible expenses. The statement must be titled “Revenue Procedure 2020-51 Statement,” and must include (i) the taxpayer's name, address, and social security number or employer identification number, (ii) a statement specifying whether the taxpayer is an eligible taxpayer under the safe harbor provisions of Revenue Procedure 2020-51, (iii) a statement that the taxpayer is applying safe harbor provisions in Revenue Procedure 2020-51, (iv) the amount and date of disbursement of the taxpayer's covered loan,(v) the total amount of covered loan forgiveness that the taxpayer was denied or decided to no longer seek, (vi) the date the taxpayer was denied or decided to no longer seek covered loan forgiveness, and (vii) the total amount of eligible expenses and non-deducted eligible expenses that are reported on the return.

Revenue Procedure 2020-51 provides that it does not preclude the IRS from examining other issues relating to the claimed deductions for non-deducted eligible expenses, including the amount of the deduction and whether the taxpayer has substantiated the deduction claim; and does not preclude the IRS from requesting additional information or documentation verifying any amounts described in the statement required to be attached to the taxpayer's return; and that the revenue procedure is effective for taxable years beginning or ending in 2020.

If you would like to discuss this IRS guidance or any other federal income tax matters, please contact your GableGotwals attorney, or a member of our Tax Law Practice Group which includes:

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