

IRS Denies Deductions for Expenses Paid with PPP Funds – For Now



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In [IRS Notice 2020-32](#) issued on April 30, 2020, the IRS has clarified that no deduction is allowed for expenses paid with funds loaned to a business through the CARES Act's Paycheck Protection Program if payment of the expense results in forgiveness of the loan. However, members of Congress are already expressing their displeasure with the IRS decision, and could potentially step in to override the ruling in the near future.

The Paycheck Protection Program, or PPP, was established by the CARES Act and provides loans to small businesses to help cover payroll costs, rent, mortgage interest, and utilities during the COVID-19 pandemic. PPP loans will be forgiven to the extent the recipient business uses the funds for allowed expenses during the 8-week period after receiving the loan. For a detailed discussion of the PPP loan program, see [here](#).

Section 1106(i) of the CARES Act specifically excludes from gross income the forgiven amount of a PPP loan that would otherwise be treated as forgiveness of indebtedness income. However, the Act does not specifically address whether a recipient business is allowed to take a deduction for the expenses paid with forgiven PPP funds. The IRS aimed to address this open question in Notice 2020-32, concluding that PPP-funded expenses are not deductible.

The IRS's Notice relies on section 265 of the Internal Revenue Code, which provides that any deduction otherwise allowable is disallowed to the extent the deduction is allocable to tax-exempt income. The IRS states that the purpose of section 265 is to prevent a double tax benefit. The Notice concludes that, to the extent section 1106(i) of the CARES Act excludes the forgiven amount of a PPP loan from gross income, such funds are considered tax-exempt income under section 265. Accordingly, section 265 disallows any otherwise allowable deduction for the payment of expenses with PPP loan funds which result in forgiveness of the PPP loan.

Per the [Wall Street Journal](#), Sen. Chuck Grassley, the chairman of the Senate Finance Committee, said in a statement released shortly after IRS Notice 2020-32 that he believes the IRS Notice "is contrary to [the] intent" of the PPP to maximize a small business's ability to maintain liquidity, retain employees and recover from the COVID-19 Pandemic as quickly as possible. Congress would need to pass legislation to overturn the IRS Notice and specifically allow PPP-funded deductions. Nonetheless, as with many other provisions of the CARES Act, it seems that this latest guidance from the IRS may still be subject to change.