"In These Uncertain Times": The Tax Consequences of PPP Loan Forgiveness

Craig Cockrell
ccockrell@mwlaw.com
(479) 464.5683

11/05/2020

“These uncertain times” has been an often used phrase over the course of the last several months, and in no facet of 2020 life is it more applicable than the Paycheck Protection Program (PPP) loans implemented as part of the CARES Act. In a matter of just a few months, the Small Business Administration and the Internal Revenue Service oversaw the issuance of over 5 million PPP Loans totaling over $500 billion, all while continually revising, updating and wholesale changing the rules governing the program.

Most borrowers have now received and spent their loan proceeds during their applicable 8 or 24 week covered period, and are now turning their attention to the next phase of the program: applying to SBA for forgiveness of the loan. Not surprisingly, there are still facets of the forgiveness process that remain unsettled. One of these areas of uncertainty is the tax treatment of expenses paid for with PPP loan funds.

The CARES Act explicitly states that any PPP loan funds that are forgiven will not trigger debt-forgiveness income. However, it was unclear from the text of the legislation whether borrowers would be allowed to deduct the payroll, rent, and other business expenses paid for with their loan funds. The IRS seemingly answered this question definitively in Notice 2020-32, declaring that borrowers were not allowed to deduct otherwise deductible expenses if the payment of the expense results in forgiveness of a PPP loan, concluding that to allow such a deduction would result in a double tax benefit. The backlash to the IRS’s position was swift and wide-ranging. The American Institute of Certified Public Accountants (AICPA) and more than 170 other business and trade organizations have voiced their opposition to the IRS’s position, asking congressional leaders to amend the CARES Act to allow PPP-funded expenses to be deducted. Despite support from both sides of the aisle, congress has not yet been able to make this change.

Assuming the IRS position remains intact, the question then becomes how PPP borrowers are expected to report the expenses on their 2020 tax returns if they have not yet been granted forgiveness for their loans. It seems clear from the IRS notice that the expenses are deductible unless they are directly related to forgiven loan funds. If so, should a borrower that has not yet applied for forgiveness by the time it files its 2020 tax return deduct the PPP expenses on its 2020 tax return? If so, and if forgiveness is later granted by SBA, will the borrower be required to amend its 2020 return, or will Treasury implement a procedure for reporting the expenses in a later year? Is it possible that Congress could get its act together between now and tax filing season to undo the IRS Notice? At this point, there are no concrete answers to these questions.

For borrowers and their advisors struggling with these questions, there is one definitive way to address them: apply for forgiveness as soon as possible. Although there is no certain deadline to apply for forgiveness in the CARES Act or SBA guidance, the de facto deadline is 10 months from the end of the borrower’s applicable 8 or 24 week covered period, since that is the date borrowers will have to start repaying their PPP loans if they have not been granted forgiveness by that time. However, in order to avoid having to face the uncertainty of how to report the PPP expenses, and potentially amending tax returns, borrowers should endeavor to submit their forgiveness applications as soon as possible. If by the time a borrower files its 2020 tax return, it knows the amount of its loan that has been forgiven, it can then report with certainty the deductibility, if any, of the expenses paid for with PPP funds. And "in these uncertain times," it's a good idea to seek as much certainty as possible, at least until the rules change again.