



Deducting Forgiven PPP Loan Expenses

This email is directed to clients who received a Paycheck Protection Program Loan (PPP).

Applying for Loan Forgiveness:

There has been some support in Congress for the idea that all PPP loans of less than \$150,000 be automatically forgiven, with no application for forgiveness required. If a business with a loan of less than \$150,000 were to apply for forgiveness now, and have some, but not all, of the loan forgiven because all of the conditions were not met, it could cause some confusion if Congress later passed a bill stating that all such loans are automatically forgiven. And, any time and effort spent on the loan forgiveness application, including fees to us if we assisted with the process, would have been a waste of time and money. For that reason, we are recommending that all businesses who received less than \$150,000 wait for further guidance from Congress on this issue.

If you received more than \$150,000, we could begin a discussion of assisting you with the Loan Forgiveness application, or if you are comfortable doing so, you could complete the application yourself.

The deadline to apply is ten months after the end of your 24 week period. So, "Date of Funding + 24 weeks + 10 months". We've got plenty of time. We will likely be unable to work on Loan Forgiveness applications during our busy tax season.

Deductibility of Expenses paid with Forgiven PPP Loan Funds:

The Internal Revenue Service recently published Revenue Procedures 2020-27 and 2020-51, and Notice 2020-32. In them, the IRS has said that they will not allow a deduction for any expenses that were paid from PPP loan funds that were, or are expected to be, forgiven.

<https://www.irs.gov/pub/irs-drop/n-20-32.pdf>

When Congress passed the CARES Act, they included a provision that if the loan is forgiven, the forgiven loan *does not have to be included as income*. For the IRS to interpret this to mean that expenses paid with PPP funds are not deductible accomplishes exactly what Congress had hoped to avoid: A situation where the help they were providing to small business would result in additional taxable income to the business. We do not agree with the IRS position on this. We think their recent publications are contrary to the intent of Congress. The role of the IRS is to interpret tax law. They have no authority to

create laws on their own. That is the role of Congress. There is nothing in the CARES Act stating that the expenses paid with forgiven PPP loan funds are not deductible.

We are not alone. There are many [articles](#) on the internet by CPAs, attorneys and other tax experts expressing that they feel that the IRS is wrong. And, the American Institute of CPAs, the largest association of CPAs in the country, recently launched a campaign to flood members of Congress with a letter requesting that they pass a new bill that will specifically state that expenses paid with forgiven PPP loan funds be deductible, which would put this matter to rest.

<https://www.journalofaccountancy.com/news/2020/nov/aicpa-members-push-for-deductibility-of-ppp-funded-expenses.html>

However, it is entirely possible that they will not. If that happens, we will offer our clients a choice:

- Follow the IRS position and leave the expenses paid with forgiven PPP funds off the return. The impact will be that taxable income for 2020 will be increased by the amount of your PPP loan that you expect will be forgiven (in many cases, all of it). Or,
- Deduct all of your expenses, as we believe was intended by Congress when they wrote the CARES Act. If you choose to do this, we strongly recommend that you attach Form 8275 to your return and disclose the fact that you have included deductions on your return that the IRS does not allow per the Revenue Procedures and Notice above. By disclosing this fact on your return, you protect yourself against penalties that could be imposed if the IRS were to disallow the deductions.

Example: ABC Company, Inc., an S Corporation, received a PPP loan of \$100,000. \$90,000 of this amount was used to pay qualifying expenses, and is eligible for forgiveness. ABC Company files their 2020 tax return and claims all of their expenses, including those paid with forgiven PPP funds. The 100% owner of ABC Company, Inc., is in a 24% income tax bracket, so claiming the \$90,000 in deductions that the IRS has claimed he is not entitled to saves him \$21,600 in tax.

Possible Outcome 1: Two years later, the IRS audits ABC Company, Inc., and its owner, and rules that the \$90,000 of forgiven PPP loan funds cannot be deducted on the owner's return. If the owner filed Form 8275 and disclosed the position, the owner will have to pay back \$21,600 in tax, plus interest, presently at 3% per year; \$1,296.

Possible Outcome 2: Two years later, the IRS audits ABC Company, Inc., and its owner, and rules that the \$90,000 of forgiven PPP loan funds cannot be deducted on the owner's return. If the owner did NOT file Form 8275 and disclose the position, the owner will have to pay back \$21,600 in tax, plus interest, presently at 3% per year; \$1,296, plus the 20% substantial understatement penalty, plus the failure to pay penalty at 1/2% per month; \$6,912 in penalties. It would actually end up being more than that because they charge interest on the penalties, too.

This is why we recommend the disclosure!

If Congress does not act to overrule the IRS on this matter, we think it is likely to be decided in the courts, which could be years from now. If you do not claim the expenses, as the IRS is instructing, it is possible that at that point, if the IRS were to lose in court, you would be allowed to file an amended return for 2020, claim the expenses, and get a refund. They would then pay you interest, presently at 3% per year. But generally, you only have three years to file a claim for a refund on an amended return.

So even if the IRS were to lose, it is possible that you would not be allowed to claim the expenses at a later date. Things like this move through the courts very, very slowly.

Claiming the expenses despite IRS's clear view that they are interpreting the CARES Act to say that the expenses paid with forgiven PPP loan funds are not deductible is an aggressive tax position, and there is significant risk that you would owe money to the IRS in the future. However, in our view, if you do not claim the expenses, and in the end Congress or the Courts determine that you were allowed to claim them, there is also a significant risk of paying income tax that you never should have had to pay.

It is entirely possible that the IRS would prevail in court. This is uncharted territory, and anything could happen. There has never been anything like the Paycheck Protection Program before.

Our role is to advise you of this matter, and let you decide. We do have some time to make this decision, and, there is also time for Congress to act and remedy what we view as a grave error in judgment on the part of the IRS. However, if we are providing tax planning advice to you based on the profits of your business, we need to include or exclude these expenses when providing that advice.

Please respond to this email with:

1. The amount of the PPP Loan that you received (even if it's \$0).
2. The amount you expect to be forgiven.
3. Whether or not you plan to deduct expenses paid with forgiven PPP loan funds, despite the IRS position that those expenses are not deductible.

We will then use this information when providing guidance to you for tax year 2020. You can make your final decision regarding the deduction, later.

If you have any questions, please feel free to contact us.



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