

IRS CLARIFIES DELAYED PPP FORGIVENESS FILING WILL NOT ENHANCE DEDUCTION AVAILABILITY POSITION

Hodgson Russ Federal-International Tax Alert
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While under the CARES Act, forgiveness of any portion of a Paycheck Protection Program (“PPP”) loan is expressly excluded from federal income inclusion, in Notice 2020-32, released on April 30, 2020, the U.S. Treasury and the IRS made it clear that their view was that expenses paid with such forgiven loan proceeds would not be deductible. Newly issued guidance clarifies that delaying PPP forgiveness certification into 2021 will not enhance a 2020 deduction availability position.

Since such time, some commentators and practitioners seized upon the nuance in Notice 2020-32 that suggested it may only apply to PPP loans actually *forgiven* rather than merely potentially *forgivable* in the future. The same commentators and practitioners then suggested that if the forgiveness application process is delayed until 2021, and thereby assuring no clear forgiveness in 2020, the taxpayer may argue that a tax deduction is available in 2020. Plenty of others questioned the solid footing of the position in light of the expected forgiveness and that, among other obstacles, a 2020 deduction could be short-lived if the so-called “tax benefit rule” applied in 2021 making the taxpayer take such previous deductions into income in 2021 once the loan was forgiven.

Rumors have circulated for weeks that the IRS was going to issue additional guidance or clarity on this issue and on November 18, 2020 the IRS confirmed those rumors with the issuance of Revenue Ruling 2020-27 and Revenue Procedure 2020-51. In sum, the IRS has attempted to shut-down the deduction end-run described above.

- In *Revenue Ruling 2020-27*, the IRS holds that, even if forgiveness has not been confirmed or the taxpayer has not applied for forgiveness before year-end, taxpayers cannot deduct expenses paid for with PPP funds if they reasonably expect the loan will be forgiven. The Revenue Ruling provides two scenarios applying this standard, and the IRS concludes in both scenarios that the taxpayers cannot deduct expenses funded with PPP loans because they have a reasonable expectation of forgiveness.
- In scenario 1, the taxpayer satisfies all of the requirements to have the PPP loan forgiven and applies for forgiveness prior to its 2020 tax year-end, but it has not

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received a response from its lender as to whether the PPP loan will be forgiven prior to the end of that tax year.

- In scenario 2, the facts are the same as scenario 1, but the taxpayer expects to apply for forgiveness in its subsequent tax year (2021).
- In accompanying *Revenue Procedure 2020-51*, the IRS provides a safe harbor for taxpayers whose PPP loan forgiveness has been partially or fully denied (or who decide not to seek forgiveness) and who wish to claim deductions for otherwise eligible payments on an original return, an amended return, or an administrative adjustment request for the 2020 tax year or, in certain situations, on its original return for the subsequent tax year.

It seems for now, taxpayers and their advisors will have to hope and wait for a legislative solution to the PPP expense deduction denial problem. A number of lawmakers have suggested that the deduction denial is at odds with the intention of the PPP legislation within the CARES Act. Several proposed bills have included deduction denial relief but remain stalled on Capitol Hill for the time being, leaving the likelihood of any legislative clarity uncertain.

For more general information on the PPP program, please see our prior alerts located at our Coronavirus Resource Center and our CARES Act page to access information related to both of these rapidly evolving topics.

Please contact Brad Birmingham (716.848.1511) or William Turkovich (716.848.1212) with any questions you may have regarding the PPP or the above IRS guidance.

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