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Client Advisory

IRS Denies Deductions for Amounts Paid with Forgiven PPP Loan Proceeds

On April 30th, the IRS addressed a question many tax practitioners have been asking over the last few weeks. Put simply: Are otherwise deductible expenses which are paid with the proceeds of the new Paycheck Protection Program (PPP) loans, whose loans are ultimately forgiven under the PPP program, deductible?

The short answer is no, per the IRS. As the IRS summarized its position in Notice 2020-32: “this notice clarifies that no deduction is allowed . . . for an expense that is otherwise deductible if the payment of the expense results in forgiveness of a covered loan pursuant to [the PPP program] and the income associated with the forgiveness is excluded from gross income for purposes of the Code pursuant to . . . the CARES Act.”

So, the following costs which are paid with the proceeds of these loans are not deductible if the loan is forgiven: payroll costs, certain employee benefits relating to healthcare, interest on mortgage and other debt obligations, rent and utilities.

The IRS position is premised on a long-standing provision of the Internal Revenue Code - - Section 265, which denies deductions for amounts paid that are allocable to income which is exempt from income taxes. Income which is so exempt includes income which is excluded from gross income under one of the income tax provisions of the Code or a provision of any other law (such as the CARES Act).

If it helps to understand the IRS position, the purpose of Section 265 is to prevent a double tax benefit, such as a business receiving monies which are not subject to income tax (e.g., forgiven PPP loan proceeds), yet claiming a deduction when those monies are spent for their intended purpose (e.g., payroll costs).

The IRS position does not surprise us, as it is not inconsistent with prior rulings and case law. What is surprising is that when Congress passed the CARES Act and promoted its benefit of a non-taxable forgivable loan if the proceeds are used to pay what we all think of as deductible expenses, none of its sponsors ever mentioned the possibility that paying those sorts of expenses with the loan proceeds may not be deductible. Congress may very well allow the IRS position to stand without comment, though it is not out of the realm of possibility that it may adopt legislation reversing the IRS's position. We are not aware of any movement to that effect as the IRS position was released only last evening, but we will monitor things and apprise you if there is a change.

In the meantime, borrowers are urged to consult with their tax advisors to determine the impact of this Notice on their own situations.

If you have questions, please contact [Gordon Moore](mailto:gmoore@archerlaw.com), who heads up Archer's [Tax Group](#), at 856- 354-3087 or gmoore@archerlaw.com, or any of your contacts here at Archer.

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