Senate Bill Introduced to Reverse IRS Position on PPP Loan Forgiveness

On May 5, 2020, Senator John Cornyn, with bipartisan support, introduced legislation that would permit borrowers that received Payroll Protection Program ("PPP") loans under the CARES Act to deduct expenses that were funded with the PPP loans. The Senate bill responds to IRS Notice 20-32 (the "Notice", found here), which provided guidance regarding the deductibility for federal income tax purposes of otherwise deductible expenses when a taxpayer receives a PPP loan. Specifically, the Notice provided 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 Section 1106(b) of the CARES Act.

Section 1106(b) of the CARES Act provided that any amount that would be otherwise includable in gross income of the recipient by reason of forgiveness described in Section 1106(b) "shall be excluded from gross income." The CARES Act did not address whether deductions otherwise allowed under the Code for payment of eligible PPP expenses are allowed if the PPP loan results were subsequently forgiven under Section 1106(b).

After the IRS issued the Notice, Senator Chuck Grassley, Chairman of the Senate Finance Committee, stated "Unfortunately, the Treasury and IRS interpreted the law in a way that prevented businesses from deducting expenses associated with PPP loans. That's just the opposite of what we intended and should be fixed. This bill will do just that."

The IRS Notice position is not surprising, based upon existing provisions in the Internal Revenue Code. Specifically, Section 265(a)(1), provides that no deduction is allowed to a taxpayer for any amounts otherwise allowable as a deduction to such taxpayer that is allocable to one or more classes of income other than interest, which are wholly exempt from taxes. Based upon its interpretation of Section 265, the IRS concluded that to the extent that Section 1106(b) of the CARES Act excludes gross income for a PPP loan forgiven under 1106(b) of the CARES Act, it results in exempt income and is not deductible, consistent with the purpose of Section 265, noting that "this treatment prevents a double tax benefit."

While the PPP loan forgiveness is still a valuable benefit to PPP loan borrowers, the IRS position would materially reduce the net benefit of the PPP loan as the net effect of the denial of the deduction may well be no different generally than the effect of the cancellation of indebtedness income.

We will continue to monitor developments with respect to the Senate bill and further IRS guidance in order to provide the most up-to-date analysis for our clients that receive PPP loans. If you have any questions about PPP loans or the IRS ruling, please contact CCM.

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