

IRS Releases Guidance On Deductibility of Qualified PPP Expenses

December 2, 2020 | **CLIENT ALERTS**

On November 18, 2020, the Internal Revenue Service (IRS) released Revenue Ruling 2020-27, which further clarifies Notice 2020-32 released on May 2, 2020. That Notice 2020-32 stated that if an entity received a Paycheck Protection Program (PPP) loan, any qualified expenses that relate to such PPP loan, or expenses for payroll, rent, utilities or mortgage interest, would be nondeductible in the event such PPP loan is forgiven.

Revenue Ruling 2020-27 addresses a lingering question that many had in regard to this notice: If the taxpayer's PPP loan had not yet been forgiven in 2020, could the qualified expenses be deducted on the taxpayer's 2020 income tax return?

The IRS has determined that if the taxpayer and PPP borrower has utilized their PPP loan proceeds for qualified expenses, and on that basis expects to receive forgiveness of its PPP loan, the taxpayer and PPP borrower may not deduct those expenses on their 2020 income tax return.

In conjunction with Revenue Ruling 2020-27, the IRS also issued Revenue Procedure 2020-51. Revenue Procedure 2020-51 creates a safe harbor for any taxpayer and PPP borrower to claim deductions based on qualified expenses. These qualified expenses will be eligible to be deducted if:

- (a) The qualified expenses are paid or incurred during the 2020 tax year;
- (b) The taxpayer and PPP borrower received a PPP loan during the 2020 tax year, and at the end of the year the taxpayer and PPP borrower expects the PPP loan to be forgiven in a taxable year after 2020; and
- (c) In such subsequent taxable year, the taxpayer and PPP borrower's request for forgiveness is denied in full or in part, or the taxpayer never requests forgiveness.

If the taxpayer and PPP borrower meets the requirements stated above, they may deduct the qualified expenses previously barred from being deducted by Revenue Ruling 2020-27. The taxpayer and PPP borrower may then deduct such qualified expenses that were denied forgiveness through:

- (a) An amended 2020 tax return which reflects the amount of qualified expenses denied forgiveness as now deductible expenses; or
- (b) An original tax return for a subsequent tax year, likely the year in which the amount of forgiveness is determined, reflecting the amount of qualified expenses denied forgiveness as now deductible expenses.

The taxpayer and PPP borrower may not deduct any qualified expenses denied forgiveness on an original or amended return in an amount greater than the principal amount of their PPP loan.

The taxpayer and PPP borrower must also attach a statement to the original or amended tax return in which they are claiming the now allowable deductions. The statement must be titled “Revenue Procedure 2020-51 Statement” and include the following:

- (a) Taxpayer’s name, address and social security number/employer identification number;
- (b) Statement specifying whether the taxpayer is an eligible taxpayer under either section 3.01 (forgiveness denied in whole or in part) or section 3.02 (forgiveness was never sought) of Revenue Procedure 2020-51;
- (c) A statement specifying whether the taxpayer is applying section 4.01 (amended return) or section 4.02 (original return in subsequent year) of Revenue Procedure 2020-51;
- (d) The amount and date of disbursement of the taxpayer’s PPP loan;
- (e) The total amount of forgiveness of the PPP loan the taxpayer was denied or never sought forgiveness for;
- (f) The date the taxpayer was denied or decided to no longer seek forgiveness of their PPP loan; and
- (g) The total amount of expenses they are now reporting as deductible on the amended or original tax return.

In summary, the IRS has stated that if a PPP borrower is expecting to receive forgiveness of their PPP loan, they may not deduct the qualified expenses relating to such PPP loan. However, if the borrower’s lender, or the Small Business Administration, determines that any part of the PPP loan will not be forgiven, they may either amend their 2020 tax return to utilize the now allowable deductions, or take the now allowable deductions in a subsequent tax year.

If you have any questions on the deductibility of qualified PPP expenses, or any other PPP questions, please contact us at Lippes Mathias Wexler Friedman LLP.