

## **U.S. Insight: IRS Clarifies Non-Deductibility of Covered Expenses in Relation to PPP Loan Forgiveness**

The Internal Revenue Service (IRS) issued further guidance on the non-deductibility of covered expenses (generally, payroll, rent, and utilities) if the payment of those expenses results in the forgiveness of a loan granted under the Paycheck Protection Program (PPP). In late April, the IRS issued Notice 2020-32 in which it announced that no deduction is allowed under the Internal Revenue Code (Code) 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 Coronavirus Aid, Relief, and Economic Security Act (CARES Act) and the income associated with the forgiveness is excluded from gross income for purposes of the Code pursuant to Section 1106(i) of the CARES Act.

Businesses suffering under the strain of the pandemic were hoping that IRS guidance would grant relief from the non-deductibility policy of the IRS. Instead, the IRS reaffirmed its position by issuing Revenue Ruling 2020-27, in which it rules that covered expenses are not deductible in 2020 to a taxpayer that met all requirements and applied for loan forgiveness in 2020 even if the taxpayer is not informed in 2020 whether the loan would be forgiven. The IRS further ruled that covered expenses are not deductible in 2020 to a taxpayer that similarly has met all requirements for loan forgiveness in 2020, but does not apply for loan forgiveness until 2021. Essentially, the IRS clarified that the timing of the application for the loan forgiveness has no effect on the deductibility of the covered expenses for federal income tax purposes. The upshot is that taxpayers should not delay the application for loan forgiveness, as such delay to 2021 does not make the otherwise non-deductible 2020 covered expenses deductible.

The IRS did, however, provide relief under Revenue Procedure 2020-51, to those taxpayers who forego or are denied forgiveness of debt under the PPP. Even if a taxpayer expects at the end of 2020 that the PPP loan would be forgiven in 2021, such taxpayer can claim a safe-harbor deduction, in a taxable year beginning or ending in 2020, for covered expenses paid or accrued in 2020 if the taxpayer's request for forgiveness of the covered loan is denied, in whole or in part, or the taxpayer decides never to request forgiveness of the covered loan. A taxpayer may be able to deduct some or all of the eligible expenses on the taxpayer's timely filed, including extensions, original income tax return or information return, as applicable, for the 2020 taxable year, or an amended return or an administrative adjustment request under Section 6227 of the Code for the 2020 taxable year, as applicable; or the taxpayer's timely filed, including extensions, original income tax return or information return, as applicable, for the subsequent taxable year.

It should be noted that the IRS' position on the non-deductibility of covered expenses is not uncontroversial. Immediately after the IRS' issuance of Revenue Ruling 2020-27, Senate Finance Committee Chairman Chuck Grassley (R-Iowa) and Ranking Member Ron Wyden (D-Ore.) released a joint statement that provides that Congressional intent was for the payment of covered expenses to be deductible. In addition, Senators Grassley and Wyden have asked that the IRS reconsider its position on the non-deductibility of covered expenses. It is possible that Congressional action may overrule the policy position of the IRS, but that remains to be seen.

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